

Sale: An Alternative Succession Route for Family Firms. Valuation Issues and Acquirers' Perception.

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INTRODUCTION

Family firms form the majority of organizations around the world (Burkart, Panunzi, & Shleifer, 2003). However, only few survive beyond the first generation (Poza, 2007). Traditionally, intergenerational succession has been equated to the success of a family firm. Passing the firm on to children was always regarded as the central task. This fact is mirrored in the family business literature with succession being the most researched domain. However, very little has been said about succession routes alternative to intergenerational transfer (Goosens, Manigart & Meuleman, 2008, Scholes, Wright, Westhead, Burrows, & Bruining, 2007; Vought, Baker, & Smith, 2008). The view that handing over the family firm to the children is the only way to go appears somewhat limited and distant from the reality. Indeed, family business owners often use the term “pass along” to mean both transferring ownership to the next generation and selling the firm to pass along the wealth created by the business (Vought et al., 2008). In effect, some families want and can be passed on to multiple generations, while others may be unwilling or unable to do so. Empirical research suggested that some owners may perceive that there are no suitable family members to whom ownership and leadership can be transferred (Wright, Thompson, & Robbie, 1992; Bierly, Ng, & Godfrey, 1999). Accordingly, for some business families an exit can be a positive choice (Birley et al., 1999). Consequently, more research is needed that would recognize a sale as a viable option for a family firm and cover this and other alternative succession routes.

The thesis focuses on an alternative succession route for family businesses, i.e. sale, with a particular emphasis on valuation and acquirers’ perception of family firm targets. In order to cope with the research objective, I implemented a variety of methods, some of which have never been employed in previous family business studies.

The research is divided into the following three chapters, each one corresponding to a paper:

1. Measures of Value in Acquisitions: Family Versus Non-Family Businesses
2. Family Firms in the Eyes of Private Equity Companies
3. Family Firms – Risky Acquisition Targets?

The first one has been submitted to a refereed journal and is in the final stage of peer review (three submissions in total). To present the second paper I was invited to an international conference on ownership transfer in privately-held businesses in Stockholm, Sweden. The third paper and in part also the second one are a result of a research period at The Wharton School, University of Pennsylvania (Philadelphia, USA), financed by the Swiss National Science Foundation. Three different datasets have been used for every paper. All the data was collected by me exclusively for the purpose of the doctoral thesis and current or future publications, based on the thesis materials.

The focus of the first paper is to compare valuations of privately-held family versus non-family business targets in the acquisition context. Our main finding is that although most theoretical and empirical research explicitly recognize the prevalence and superior performance of family businesses around the world, acquirers are unable to recognize the advantages associated with family businesses and thus acquire them at a discount as compared to non-family business counterparts.

The second and third papers analyze the perception of family firm targets by an important class of acquirers, private equity firms. The second paper has an exploratory character and was meant to lay the ground for the overlooked topic of family firm acquisitions and in particular to examine this topic from the acquirers' perspective. We found that one half of the private equity professionals surveyed flag the fact that a potential acquisition target is a family firm, but only for

a third this difference would translate into valuation, mostly a discount. To some extent, this is explained by the higher risk attributed to family firm targets. We also noted that private equity professionals may equate family firms to small businesses.

Findings from the second paper underlie the questionnaire constructed for the third paper that studies private equity firms' attitude towards family firm target in more detail. Here it is noted that family firm targets are indeed perceived to be riskier by their acquirers and that this can have negative influence on the valuation. Other measures to cope with higher riskiness are discussed such as a more intensive usage of risk-mitigating measures, as well as a different structuring of the deal. It is concluded that the perception of risk, even though not always corresponding to the actual levels of risk, influences investors' behavior.

On the following pages, a summary of all the three papers is presented. This first part is closed with a brief conclusion and a short bibliography.

SUMMARY

Chapter 1: Measures of Value in Acquisitions: Family Versus Non-Family Businesses

Darya Granata and Francesco Chirico

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The increasingly rapid change in the current business environment and the need for novel solutions often motivate firms to expand their resources through acquisitions (Makri, Hitt & Lane, forthcoming). Acquisition is a unique form of entrepreneurship activity through which a company (acquirer) acquires another company (target) (Harrison, Hitt, Hoskisson & Ireland, 1991). In the latter half of the 20th century, acquisitions became a prominent strategy for many companies, large and small, to acquire complementary resources (Harrison et al., 1991). Since, their strategic use to acquire new resources has become a well institutionalized corporate phenomenon (Uhlenbruck, Hitt & Semadeni, 2006), primarily because acquisition targets provide opportunities for organizational learning by exposing the acquirer to new and diverse ideas, thereby overcoming resource based constraints to growth (Hitt, Hoskisson, & Ireland, 1990).

However, while acquisition has received considerable research attention in the strategic management literature (e.g. Harrison et al., 1991), and although family businesses are the most common form of organizations throughout the world, accounting for over 75% of all registered companies in most economies (Miller, Steier & Le Breton-Miller, 2003), only few recent studies have focused on family business' acquisitions (Basu, Dimitrova & Paeglis, 2009; Caprio, Croci & Del Giudice, 2008; Holmen & Nivorozhkin, 2007; Feito-Ruiz & Menéndez-Requejo, 2010; Mickelson & Worley, 2003; Steen & Welch, 2006). A family business is defined as an

organization in which a family has a substantial ownership stake, and has at least two of its members in key management positions (see Miller, Le Breton-Miller, Lester & Cannella, 2007; Westhead & Cowling, 1998; Zahra, Neubaum & Larraneta, 2007).

A central issue in any acquisition is the valuation of the target company by the acquirer – a measure that determines the price to be paid for acquisition (i.e. acquire at a discount or premium). Surprisingly, none of the aforementioned family-business studies compared valuation of privately-held family business targets with non-family business targets. Our empirical research attempts to fill this gap in the family-business literature, thus suggesting important implications for research and practice. Two major views have been constructed regarding the nature of family businesses: stagnation vs. stewardship (Miller, Le Breton-Miller & Scholnick, 2008). The stagnation perspective proposes that family organizations face unique challenges to growth and expansion mainly because of resource restrictions. Alternatively, the stewardship perspective suggests that family members view themselves as stewards of the family business, and thus nurture it for the support of future generations through stewardship over the continuity of business, employees, and customer relationships. This enables family businesses to perform better than non-family businesses. Miller et al. (2008)'s findings fully substantiate the stewardship perspective but not the stagnation perspective (see also Anderson & Reeb, 2003).

Building on the above-arguments, we argue that although most theoretical and empirical research explicitly recognize the prevalence and superior performance of family businesses around the world (Anderson & Reeb, 2003; Astrachan & Shanker, 2003; Koironen & Chirico, 2006; Miller et al., 2008; Sharma, 2004), acquirers tend to regard family business as an unprofessional and inefficient organization in which decision-making processes are driven by emotions rather than by economic rationality (Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson & Moyano-Fuentes, 2007). Hence, acquirers are unable to recognize the advantages associated with

family businesses and thus, are disposed to pay a lower price (i.e. acquire at a discount) for a family business target than for a non-family business target. The negative consequence for the family business target is evident: it gets less money than it is worth. Meanwhile, the acquirer, who underestimates the family business target's value, risks losing valuable investment opportunities when the family-business target is not willing to sell at a lower price. We believe that a focus on family businesses may both advance knowledge on the evaluation of target firms and help us understand specifically *why* acquiring companies tend to pay a discount price for family business targets as compared to non-family business targets.

The potential insights that can be gained by addressing evaluation issues in acquisitions from a family perspective result from the unique and distinguished features of family when compared to non-family businesses. Tangible and intangible resources are indeed unique in a family business since they result from interactions between the family, its individual members, and the business (Sirmon & Hitt, 2003). The family business is the only organization in which family members are simultaneously active in the family and the business, hence significantly influencing business performance (Chirico & Salvato, 2008). When the target company is a family business whose economic value stems not only from the business but also from the family, evaluating such business can become quite complex. Thus, this form of organization requires a detailed examination from both the family and business' aspects at the time of acquisition. However, acquirers generally tend to focus their attention on the negative aspects of a family business. In their eyes, stagnation drawbacks prevail over stewardship advantages, thus underestimating its real value.

We explore the overlooked topic of valuing family businesses within the context of acquisition, using a unique dataset of privately-held family and non-family business targets. Given that the valuation of both privately-held family and non-family businesses is a difficult and

often highly subjective process, especially because a privately-held company has no observable stock price to serve as an objective measure of market value, we relied on valuations from recent acquisitions. We employed a matched-pairs method for statistical analysis, and the standard technique of multiples as measures of value (see Alouche, Amann, Jaussaud & Kurashina, 2008; Koeplin, Sarin & Shapiro, 2000). We note the absence of multiples in previous family business literature. Overall, our empirical analysis confirms that acquiring companies are unable to recognize the advantages associated with a family business target compared to a non-family business target, and consequently, pay less (i.e. acquire at a discount) for a family business. Accordingly, we offer practical implications for potential family business targets as well as their acquirers.

Chapter 2: Family Firms in the Eyes of Private Equity Companies

Darya Granata and Patrizia Gazzola

Presented at the “Transfer of Ownership in Private Businesses – European Experiences”, an international conference on the current research, policies and practices related to transfer of ownership Stockholm, Sweden, March 25th – 26th, 2010.

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Succession is probably the most challenging task in family firms and hence it is the oldest and the most researched domain in the family firm academia. This topic continued to be prevalent throughout the whole history of the family firm academic research, i.e. the last thirty years (Chittoor & Das, 2007). However, very little has been said about succession routes alternative to the transfer to the next generation (Goosens, Manigart & Meuleman, 2008). The ownership transfer can take different forms such as sale to a strategic or a financial buyer, management buyout or buy-in and initial public offering (IPO). In this paper we address the issue of family

firm succession outside the family and particularly devote our attention to a highly important class of acquirers such as private equity firms. The Centre for Management Buy-out and Private Equity Research revealed that 38% of European buyouts in 2007 were targeting family firms (CMBOR, 2007) and that 62% of family businesses are acquired by private equity investors according (Bytestart website, 2008). Despite the fact that there is a considerable amount of practitioner literature on private equity, it is a relatively new topic in academia (Bargeron, Schlingemann, Stulz, & Zutter, 2008). Even less developed is the academic research on private equity in family firms. It was described as being still in its infancy (Achleitner Schraml, & Tappeiner, 2008). The few studies of private equity investments in family firms (e.g. Achleitner et al., 2008; Howorth, Westhead & Wright, 2004) focused on family firm motivations and the deal process. The most similar to the current study is research by Dawson (2009) who examined decision-making models used by Italian private equity investors in their selection of family firms. Our study however deals with a broader range of family firm attributes that was possible thanks to not restraining private equity respondents to a predefined set of characteristics.

The purpose of this study was to determine how investors perceive family firm targets and whether this perception translates into money terms, i.e. if the fact that a target is a family firm has an influence on its valuation. A major contribution of this article is that it explicitly assesses what picture of family firms do private equity firms have and whether there are any consequences for the valuation.

We believe that the topic of family firm succession is highly important and that there is a burning need to close the gap in the literature. From the theoretical point of view, it is important for the following reason. Family business academia and family firms themselves recognize their distinctiveness. But what about third parties, in particular investors, do they perceive family firms as a separate class of companies and what characteristics do they attribute to family firms? From

the practitioners' point of view, understanding private equity firm perception of family firms can benefit both sides. Acquirers can benchmark attitude towards family firms and be better prepared to handle family firm investments. Family firms can understand acquirers' perception, address weaknesses and potentially achieve a higher valuation. This issue has been ignored not only from the family firm scholars, but also from private equity scholars who focus their attention on large public-to-private transaction leaving the family buyout part understudied (Cumming, Siegel & Wright, 2007). Dawson (2009) argued that private equity professionals among others use family firm specific criteria. However, there were no previous studies of what these criteria are and we did not believe that it was possible to create an exhaustive list of family firm characteristics when these firms are in the role of an investment target. What we wanted to achieve was a picture of family firms drawn by the companies that routinely analyze numerous privately-held family firm targets. In general terms, rather than testing a hypothesis about reality, we were looking to make a statement about how actors interpret reality (Suddaby, 2006). Consequently, our work is organized in the form of a qualitative study and has rather an exploratory character. We employed the content analysis technique to analyze the last question concerning family firm characteristics and adopted a four-stage interpretive approach to the manual classification of open-ended responses suggested by Taber (1991).

A survey was conducted from October to December 2008 and included the whole population of private equity firms that have acquired Western-European companies in the last eight years and were covered by the Mergermarket database. The study is based on 14 phone interviews and 140 written responses and was followed up with 5 face-to-face and 1 phone expert interviews.

Results from this research revealed that one half of the private equity professionals we have surveyed flag the fact that a potential acquisition target is a family firm. Only for a third

however this difference would translate into valuation. The ones that would value a family firm differently lean towards negative valuation and to some extent, this is explained by the higher risk attributed to family firm targets. Other characteristics suggest that private equity professionals may equate family firms to small businesses. Finally, most of family firm weaknesses correspond to the measures that private equity firms usually undertake. Consequently, the shortcomings of family firms may be overcome through the active management and represent an untapped potential. Scholes, Wright, Westhead, Bruining, & Kloeckner (2009) confirm this proposition.

We hope that our findings and conclusions will inspire new studies on private equity investments in family firms, as well as other alternative succession routes. For decades, we have been well-served by studies of succession that focus on the passing the firm to the next generation. Yet succession takes other forms and, given the large amount of families exiting their business, this topic warrants further conceptual and empirical analysis. We also believe that our study contributes to the understanding of family firm perception by third parties and that further research on how external groups such as investors and customers view this unique type of organization is justified.

Chapter 3: Family Firms – Risky Acquisition Targets?

Darya Granata

Result of the research period at The Wharton School, University of Pennsylvania (Philadelphia, USA), financed by the Swiss National Science Foundation.

Although traditionally family firm literature was almost exclusively dedicated to the topic of intra-family succession and was seeing a sale of a family firm as a failure, finally we can find some academic researchers arguing that both keeping and selling the business could be viable

success options for business families (Dana & Smyrnios, 2010). In fact, a high number of families around the world is actually considering to sell (Halter, Schrettle, & Baldegger, 2009; Gow, 2007; Smyrnios & Dana, 2006, 2007).

This chapter reports a study of private equity professionals' attitude towards family firm targets and is one of the very few articles trying to understand acquirers' perception of family firms. The objectives of the study were threefold. First, it was intended to further develop the qualitative findings from an exploratory study on family firm targets' perception by private equity firms (Chapter 2) that was aimed to open up a discussion about family firms as acquisition targets. The most prominent characteristic from the previous chapter was higher riskiness of the family firm targets. Consequently, a major attention was given to the exploration of this trait, as well as better understanding of its consequences and mitigating measures private equity firms employ. Second, it is hoped that the results will provide members of the private equity community, as well as other financial and strategic acquirers, with an aggregate picture of family firms and in particular outline risks associated with this type of targets. Finally, this study should help selling families pinpoint their weaknesses, take the steps necessary to improve them and consequently be able to negotiate a higher valuation.

The questionnaire was based on the findings from the chapter two of this thesis. The survey instrument consisted of 13 major questions relating to various family firm targets' risks, risk-mitigating measures, valuation, investment process and familiarity with the family firm targets. Answers were measured using a 7-point Likert-type rating scale.

The study was organized in the following steps. In-depth face-to-face discussion of the initial draft of the questionnaire with eight experts served a twofold purpose. First, I wanted to examine if respondents understood all the items in the way I meant them to be understood. Second, experts suggested additional items. Although, all the suggestions were very valuable, I

only stuck to additional items that corresponded to the purpose of the research. The following individuals were involved as experts: two private equity professionals, one consultant to private equity firms, two family business and one entrepreneurship professors, one private equity post-doc researcher, as well as one professional survey consultant. The questionnaire was then pilot tested in two stages. In the first stage, testing was performed with nine PhD and post-doc students. This time rather than using face-to-face communication, I asked them to fill out questionnaire in the electronic form, the media that I was going to use for the final study. Doctoral and post-doctoral students' comments mostly concerned wording and scale issues and were critical for the final development of the questionnaire. The scale items were then reworded based on their feedback and distributed to the participants of the last testing stage that included 23 undergraduate and MBA participants of the family business course at The Wharton School. This step gave me a glance of what the results may look like in the actual study. In addition, final version was tested for the time expense. The responses from both pilot tests were not included in the final analyses.

Electronic survey was chosen for the sake of convenience for the private equity professionals, as well as for its several attractive features such as easy data management, location flexibility, and rapid diffusion.

The whole population of the US-American buyout firms listed on the Private Equity Info website was considered for this study. Questionnaire was sent to 1,018 e-mail addresses, however the adjusted number of population to whom enquiries were sent is 879 (considering impersonal addresses, failed emails and refusals). Only fully administered questionnaires were considered for the analysis. 145 fully filled out questionnaires resulted in the response rate of 14.2% (16.5% if the adjusted number of the total population is considered). MANOVA tests revealed that sample

selection bias was not an issue in this study (Kanuk & Berenson, 1975; Sharma, Chrisman, & Chua, 2003).

Private equity professionals rather agree than disagree that family firm acquisition targets bear higher risk than their non-family counterparts. The two most important risk types are management transition risk and culture transition risk. Both of them also have the two lowest standard deviations meaning that there was quite a high level of agreement among survey participants. Open-ended question revealed several additional family firm targets' risks such as risks concerning family dynamics and lack of trust for the private equity investors.

Due diligence for dynamics of relationship and team followed by financial due diligence seem to be the most important risk-mitigating measures undertaken by the private equity investors. Among the three contractual procedures, earn-out provision seems to be the least important when dealing with family firms. High perceived riskiness of family firms is associated with greater reliance on different types of due diligence. In fact, the higher the perceived risk, the more checks are necessary.

Almost all the risk-mitigating measures are positively and statistically significantly correlated with each other. This can be interpreted in the following way: private equity professionals who tend to think some measure is more important in family firm transactions generally tend to think so about several of the measures. One of the crucial measures mentioned in the open-ended question was a non-compete agreement.

Higher riskiness of family firm investments is negatively correlated with the valuation. This means that private equity professionals perceiving family firms as riskier targets look to mitigate for this with the price. Adjusting for higher risk can also be handled with various risk-mitigating measures discussed above. In addition, one of the respondents mentioned that the discount can also be in terms of structure. The private equity professional mentioned that he or

she would always want the family to own a stake in the business junior to his or her securities. These answers to the question about reasons for a discount or a premium revealed that the main reasons for a discount are the need to replace management and the lack of infrastructure. Reasons for a premium, mentioned by a tiny number of respondents, were connected to a higher upside potential. It can be argued however that the realization of the upside potential is a merit of private equity professionals and has its costs. Consequently, it is questionable if acquirers should pay a premium for such a target.

Private equity professionals who perceive family firms as higher risk investments are also those for whom the investment period is longer. Family firm is an entity that comprises both family and business matters. Consequently, with twice as many issues to be analyzed due to higher riskiness the sale process takes longer.

Familiarity with family firms is not correlated with perception of family firms as riskier targets, neither is it correlated with any of risk types. A possible interpretation is that family firms are generally perceived as riskier targets and this perception is not dependent on the amount of experience of private equity professionals with this type of firms.

Cluster analysis was meant to reveal whether there are any broad types of private equity professionals, with common attitude towards family firm targets. A two cluster solution was adopted. The first cluster includes private equity professionals who perceive family business risks to be higher and consequently see more need in risk-reducing measures and assign lower valuation to family businesses. They are also the ones who are undecided whether family firms are turnaround situations versus the second group who somewhat disagrees with this. Process length and familiarity with family firms are the same for both clusters.

In order to explore whether there was a more general pattern underlying the responses of private equity professionals, the data was factor analyzed. In addition to the Eigenvalue-greater-

than-one rule, the scree test was employed to double-check the number of factors (Tucker, Koopman, & Linn, 1969). Analysis of risk types revealed that the risk that owners back out of transaction stands out from other types. This risk type can be hardly mitigated with any of the measures that were included in the survey. In addition, it relates more than others to transaction itself rather than to target characteristics. Examination of risk-mitigating measures also resulted in two factors. Factor one is associated with a concern of preventing negative issues that can be identified through different kinds of due diligence pre-buyout or mitigated with an escrow account post-buyout. Factor two relates to stimulating collaboration from sellers' side. Through an earn-out and a minority stake sellers should become interested that a company performs well post-buyout.

Perhaps the most important finding from this study is that family firm targets are indeed perceived to be riskier by their acquirers and that this can have negative influence on the valuation. In addition, higher perceived risk was connected with a more intensive usage of risk-mitigating measures, and a different structuring of the deal (junior versus senior securities) was suggested. Consequently, the perception of risk, even though it may be different from the actual levels of risk, influences investors' behavior.

CONCLUSIONS

The first paper found a discount for a family firm in the acquisition context notwithstanding the majority of theoretical and empirical research explicitly recognizes the prevalence and superior performance of family businesses around the world. We proposed that acquiring companies tend to regard family businesses as unprofessional and low-performing organizations, thus negatively affecting their valuation as compared to non-family business targets. We outlined harmful effects for both sides in the transaction.

The last two papers proposed in this thesis have analyzed more in depth how acquirers regard family firm targets and what can be a real reason for valuing them lower than their non-family peers. The main conclusion was that there is a higher risk involved in acquiring a family firm. For the same amount of return, a riskier asset should be priced lower, so private equity firms (and probably other acquirers as well) essentially adjust for a higher risk with price. Additional tools to handle higher perceived risk were found to be certain contractual provisions and pre-buyout checks, as well as a different structuring of the deal.

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CHAPTER 1

MEASURES OF VALUE IN ACQUISITIONS: FAMILY VERSUS NON-FAMILY BUSINESSES

MEASURES OF VALUE IN ACQUISITIONS:

FAMILY VERSUS NON-FAMILY FIRMS

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Abstract: The present article sheds light on the valuation of family firms compared to non-family firms as acquisition targets. We argue that although the majority of theoretical and empirical research explicitly recognizes the prevalence and superior performance of family firms around the world, acquiring companies tend to regard family firms as unprofessional and inefficient organizations, thus negatively affecting their valuation as compared to non-family firm targets. Overall, our empirical analysis, based on a matched-pairs methodology and use of multiples, shows that acquiring companies favor the stewardship perspective rather than the stagnation perspective and thus pay less (i.e. acquire at a discount) for a family firm target than for a non-family firm target.

Keywords: Family business sale, valuation, matched-pairs, multiples.

INTRODUCTION

The increasingly rapid change in the current business environment and the need for novel solutions often motivate firms to expand their resources through acquisitions (Makri, Hitt & Lane, 2010). Acquisition is a unique form of entrepreneurship activity through which a company (acquirer) acquires another company (target) (Harrison, Hitt, Hoskisson & Ireland, 1991). In the latter half of the 20th century, acquisitions became a prominent strategy for many companies, large and small, to acquire complementary resources (Harrison et al., 1991). Their strategic use to acquire new resources has become a well institutionalized corporate phenomenon (Uhlenbruck, Hitt & Semadeni, 2006), primarily because acquisition targets provide opportunities for organizational learning by exposing the acquirer to new and diverse ideas, thereby overcoming resource-based constraints to growth (Hitt, Hoskisson, & Ireland, 1990).

However, while acquisition has received considerable research attention in the strategic management literature (e.g. Harrison et al., 1991), and although family firms are the most common form of organizations throughout the world, accounting for over 75% of all registered companies in most economies (Miller, Steier & Le Breton-Miller, 2003), only few recent studies have focused on family firms' acquisitions (e.g. Basu, Dimitrova & Paeglis, 2009; Caprio, Croci & Del Giudice, 2008; Holmen & Nivorozhkin, 2007; Feito-Ruiz & Menéndez-Requejo, 2010; Mickelson & Worley, 2003; Steen & Welch, 2006). A family firm is here defined as an organization in which a family has a substantial ownership stake, and has at least two of its members in key management positions (see Chirico & Nordqvist, 2010; Miller, Le Breton-Miller, Lester & Cannella, 2007; Westhead & Cowling, 1998; Zahra, Neubaum & Larraneta, 2007).

A central issue in any acquisition is the valuation of the target company by the acquirer – a procedure to determine the price to be paid for the acquisition (i.e. acquire at a discount or premium). Surprisingly, none of the aforementioned family-firm studies compared valuation of

privately-held family firm targets with non-family firm targets. Our empirical research attempts to fill this gap in the family-firm literature, thus suggesting important implications for research and practice. Two major views have been constructed regarding the nature of family firms: stewardship vs. stagnation (Miller, Le Breton-Miller & Scholnick, 2008). The stewardship perspective suggests that family members view themselves as stewards of the family firm, and thus nurture it for the support of future generations through stewardship over the continuity of business, employees, and customer relationships. This enables family firms to perform better than non-family firms. Alternatively, the stagnation perspective proposes that family organizations face unique challenges to growth and expansion mainly because of resource restrictions. Miller et al. (2008)'s findings fully substantiate the stewardship perspective but not the stagnation perspective (see also Anderson & Reeb, 2003).

Building on the above-arguments, we argue that although most theoretical and empirical research explicitly recognizes the prevalence and superior performance of family firms around the world (Anderson & Reeb, 2003; Astrachan & Shanker, 2003; Koiranen & Chirico, 2006; Miller et al., 2008; Sharma, 2004), acquirers tend to regard the family firm as an unprofessional and inefficient organization in which decision-making processes are driven by emotions rather than by economic rationality (Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson & Moyano-Fuentes, 2007; Salvato, Chirico & Sharma, 2010a, b). Hence, acquirers are disposed to pay a lower price (i.e. acquire at a discount) for a family firm target than for a non-family firm target. We believe that a focus on family firms may both advance knowledge on the evaluation of target firms and help us understand specifically *why* acquiring companies pay a discount price for family firm targets as compared to non-family firm targets.

The potential insights that can be gained by addressing evaluation issues in acquisitions from a family perspective result from the unique and distinguished features of family firms when

compared to non-family firms. The family firm is indeed the only organization in which family members are simultaneously active in the family and the business, hence significantly influencing business performance (Arregle, Hitt, Sirmon & Very, 2007; Chirico & Salvato, 2008; Chirico, Ireland & Sirmon, 2010). Thus, tangible and intangible resources are unique in this type of organization since they result from interactions between the family, its individual members, and the business (Sirmon & Hitt, 2003). Consequently, when the target company is a family firm whose economic value stems not only from the business, but also from the family, evaluating such firm can become quite complex. A detailed examination from both the family and business' aspects is therefore required at the time of acquisition. However, acquirers generally tend to focus their attention on the negative aspects of a family firm. In their eyes, stagnation drawbacks prevail over stewardship advantages, thus underestimating its real value.

We explore the overlooked topic of valuing family firms within the context of acquisition, using a unique dataset of privately-held family and non-family firm targets. Given that the valuation of both privately-held family and non-family firms is a difficult and often highly subjective process, especially because a privately-held company has no observable stock price to serve as an objective measure of market value, we relied on valuations from recent acquisitions. We employed a matched-pairs method for statistical analysis, and the standard technique of multiples as measures of value (see Alouche, Amann, Jausaud & Kurashina, 2008; Koeplin, Sarin & Shapiro, 2000). We note the absence of multiples in previous family firm literature. Accordingly, we offer practical implications for potential family firm targets as well as their acquirers.

This article is organized in the following manner. We first review the literature on resource-based logic in acquisitions. We then discuss the advantages and disadvantages of the family firm, and explore how it is perceived by external investors in the acquisition process.

Accordingly, we develop our hypothesis followed by a description of the methodology. The paper ends with the results, discussion, contributions and limitations of the study. Implications for research and practice are shared in the concluding section.

RESOURCE-BASED LOGIC IN ACQUISITIONS

The resource-based view of the firm is a useful framework for studying the sources of value creation (Sirmon, Hitt & Ireland, 2007). The essence of resource-based logic rests in an emphasis on bundles of unique tangible and intangible resources at the firm's disposal as the foundation for creating value and competitive advantages (Barney, 1991). The common factor driving acquisition strategies is that in dynamic markets with increased globalization, it is hard for a single firm to possess all resources needed to develop and sustain current competitive advantages. Thus, most organizations rely on other organizations to help support growth objectives (Chirico, Ireland & Sirmon, forthcoming; Harrison, Hitt, Hoskisson, & Ireland, 1991; Li, Eden, Hitt, & Ireland, 2008). Furthermore, the complexity of modern products and services, and the changing consumer demands, increase interdependence among organizations and amplify the need to recombine resources (Capron, Mitchell & Swaminathan, 2001; Sirmon et al., 2007). In this instance, no other combination of firms can produce the same value, meaning that the synergy is the source of a competitive advantage (Makri et al., 2010). Novel resources that a firm cannot create independently are thus developed and new markets are entered through acquisitions. Accordingly, Hitt, Hoskisson, and Ireland (1990) argue that acquisitions may serve as a substitute for innovation. For example, firms may acquire target companies with technology different from their own so as to acquire new product lines without assuming high risks involved in internal innovation (Harrison et al., 1991; Hitt et al., 2001; Ireland, Hitt, & Vaidyanath, 2002; Sirmon & Lane, 2004).

In sum, firms acquire companies characterized by resources that they themselves lack, such as management teams with specialized knowledge in a specific area or market. Thus, it becomes extremely important to thoroughly evaluate the tangible and intangible resources available in the potential target company so as to determine its economic value and the price to be paid for its acquisition (see Fernández, 2002; Koeplin et al., 2000). In the next sections, we argue that the valuation issue can be specifically complex when the target company is a family firm whose economic value stems from both the family and business' sides (e.g. family members' idiosyncratic knowledge). Accordingly, we first present the family firm as a repository of valuable tangible and intangible resources which can be exploited by external investors through acquisition strategies (Arregle et al., 2007; Miller et al., 2008; Sirmon & Hitt, 2003). Then, we describe how acquirers' perception of a family firm target may strongly affect their valuation compared to a non-family firm target's valuation.

THE FAMILY FIRM

Stewardship vs. Stagnation Perspectives

That family firms play a dominant and crucial role in today's economy is now well documented (Colli, 2003; La Porta, Lopez-de-Silanes, & Shleifer, 1999). Family firms are depicted as emotionally committed organizations characterized by intense interactions among family members within the family and the business. Emotional attachment and rational judgment are inseparably intertwined, thereby significantly affecting the strategic decision-making processes (Chirico & Nordqvist, 2010; Olson, Zuiker, Danes, Stafford, Heck, & Duncan, 2003; Sirmon & Hitt, 2003). The essential qualities of family firms result in equally distinctive organizational behaviors and outcomes in which the interaction of two social systems – the family and the business – enables family members to simultaneously participate in both family

and business relationships in their personal and professional lives (Chirico & Salvato, 2008). Miller et al. (2008) found that the family firm is, in many respects, an especially salutary organizational form, repository of valuable resources and conducive to corporate longevity compared to a non-family firm (see also Chirico et al., forthcoming; Anderson & Reeb, 2003; Sirmon & Hitt, 2003).

Two major views have been constructed regarding the nature of family firms: stagnation vs. stewardship (Miller et al., 2008). The stewardship theory considers the family to be a source of competitive advantage whose uniqueness derives from the integration of family and business. In family firms, both family-member owners and managers view themselves as stewards of the family firm; their motives are aligned with the objectives of the organization which must be nurtured to support the future generations (Corbetta & Salvato, 2004). Family members are altruistically dedicated to the business and tend to place the business's objectives ahead of their own. Such an altruistic behavior helps strengthen family relations by reducing relationship conflicts and fostering trust, interdependence and commitment to the family's long term success (Corbetta & Salvato, 2004; Eddleston & Kellermanns, 2007). Miller et al. (2008) delineate the three following forms of stewardship in family firms: *Stewardship over the continuity of business*: It reflects family members' strong emotional attachment to the organization (Astrachan & Jaskiewicz, 2008; Gomez-Mejia et al., 2007; Stockmans, Lybaert, & Voordeckers, 2010) which contributes to an extraordinary commitment to proactively search for innovative strategies and exercise stewardship over the well-being and continuity of the firm in the long run (Miller & Le Breton-Miller, 2005; Miller et al., 2008; Salvato et al., 2010a, b). Stewardship over the continuity leads family firms to invest more in product research, market share and reputation developments compared to non-family firms. *Stewardship over employees*: It indicates the special care for the family firm and its continuity resulting from building "a group of talented, motivated

and loyal employees” to guarantee family’s prosperity over time (Miller et al., 2008, p. 55). To this end, intensive training programs are developed in order to coach employees to do their job well, foster the development of new products and acquire new knowledge (Chirico, 2008; Chirico & Salvato, 2008; Chirico & Nordqvist, 2010). *Stewardship over customer relationships*: It suggests that family firms are interested in “building enduring networks and associations with clients and other suppliers of valuable resources” (Miller et al., 2008, p. 56). This motivates family firms to be closer to their customers, to improve the exchange of information with them, and to consolidate their family trademark by directing more effort into marketing activities such as telemarketing and trade shows (Miller & Le Breton-Miller, 2005; Miller et al., 2008).

On the contrary, stagnation perspective depicts family firms as organizations facing the challenge of being undercapitalized and subject to conservatism and characterized by slow-growing performance and short life span (Miller et al., 2008; Morck & Yeung, 2003). Lack of financial capital often leads to deficiency of other resources such as skilled employees (Schulze, Lubatkin & Dino, 2003; Zahra et al., 2007). Parents may act altruistically towards their children, thereby hiring them despite incompetency. Talented non-family managers may have an aversion to work in family organizations when more prestigious working positions are often reserved for family members (Schulze et al., 2003). Consequently, knowledge heterogeneity to promote novel and creative ideas is substantially reduced (Chirico, 2008; Chirico & Salvato, 2008). Resource constraints may also lead to conservatism and induce family members to avoid crucial strategic decisions to maintain family security (Salvato et al., 2010a, b). As a result, such organizations may develop cultures that make them inflexible, resistant to change, and inclined to stick to path-dependent traditions that limit growth of the firm (Chirico & Nordqvist, 2010; Dyer, 1986). Some authors explicitly refer to a “generational shadow” - an enduring effect of previous strategic paths and practices on a family firm’ subsequent evolution (Davis & Harveston, 1999).

It is worthy to note and underline that Miller et al. (2008, p. 73) find support for the stewardship view and no confirmation whatsoever for the stagnation view, suggesting that “the family firm form is in many respects an especially vibrant one”. Also, Anderson and Reeb (2003) conclude that a long-term focus gives family companies a leg up over non-family rivals.

In the next sections, we will argue and empirically demonstrate that acquirers attribute a lower valuation to a family firm target compared to a non-family firm target, primarily because they perceive the family firm as an unprofessional organization in which stagnation motives prevail over stewardship motives.

Valuing Family versus Non-Family firms in the Acquisitions Context

The valuation of a target company is relevant to determine the price to be paid for its acquisition. Based on this value, the acquirer will acquire at a premium (i.e. price for a target firm > average price paid for comparable companies) or discount (price for a target firm < average price paid for comparable companies) (Koeplin et al., 2000). There are multiple approaches to company valuation, such as cash-flow discounting methods, income statement-based methods, as well as rarely used balance sheet-based and goodwill-based methods (Benninga & Sarig, 1997; Fernández, 2002).

Building on our previous arguments, a growing body of research suggests that family firms outperform non-family firms (see Anderson & Reeb, 2003; Astrachan & Shanker, 2003; Koiranen & Chirico, 2006; Miller et al., 2008; Sharma, 2004) on a number of important indices such as market capitalization, return on assets, return on equity, as well as normalized compound returns (Allouche, Amann, Jaussaud & Kurashina, 2008; Robertson, 2007). For instance, Castillo and Wakefield (2006) reported higher levels of company’s cash balance and return on investment (ROI) for family firms than for non-family firms.

Most previous studies have regarded family firms as solid and valuable organizational forms whose resources have been carefully built by family members across generations. Indeed, given that family firms are long-term oriented, family members in key management positions are induced by their strong commitment, collectivistic value, collective identity and sense of trust, and altruism to “actively intermingle business and family resources” to guarantee the continuity of their business (Haynes, Walker, Rowe & Hong, 1999, p. 238) with a reduced recourse to debt (Gallo & Villaseca, 1996). To support their collective identity based on a collectivistic culture, in which each member views himself as part of “a larger (family or social) group [focusing on ‘we’], rather than as an isolated independent being [focusing on ‘I’]” (VandenBos, 2007, p. 195), family members commit to the success of their business. They are well-disposed towards investing ‘patient financial capital’ (Sirmon & Hitt, 2003), they go beyond the call of duty, and exert extra efforts on behalf of their organization. For instance, family members are prone to make the necessary personal sacrifices and supply extra capital in the form of additional working hours, lower salary, free labor and use of personal savings to keep the business healthy across generations (c.f. survivability capital; Olson et al., 2003; Sirmon & Hitt, 2003). Moreover, they invest greater resources in employee trainings, customer relationships, and research and development of new offerings; they give more attention to boosting the reputation of the business and put more emphasis on broadening the market and the share of the market (Miller et al., 2005; 2008).

Interestingly, in a note to its clients in September 2007, Credit Suisse, one of the world's biggest investment banks from Switzerland, recommended that investors consider taking long-term positions in companies with a significant family management influence because of their superior performance. Credit Suisse publicly announced that the firms in its family index had

outperformed their sectors by an average of 8 per cent in 2007, with a similar trend since the start of their research in 1996 (Robertson, 2007).

Hence, an acquiring company whose goal is to have access to valuable complementary resources should positively value a potential family firm target's resources which are carefully built by family members across generations. Certainly, when skilled family members -repository of knowledge- are retained in the acquiring company, then stewardship advantages in terms of family members' values, devotion towards the business, human capital and enduring customer relationships persist after acquisition, thus making the family firm a genuinely valuable organizational form to be acquired. To this end, it becomes essential to retain at least some of the family members who represent repositories of specific tacit knowledge resources that may be difficult to imitate or acquire elsewhere (Chirico & Salvato, 2008; Chirico et al., 2010; Hitt et al., 2001; Zahra et al., 2007). For instance, based on a sample of 147 acquisitions, Krishnan, Miller & Judge (1997, p. 371) empirically found that the lower the turnover among the acquired firm top management team, the better the post acquisition performance. They conclude that "The acquisition process is most successful when organizational learning occurs... Furthermore, it appears that a crucial aspect of organizational learning is the blending of top management teams, rather than emasculation of one or both teams".

There are basically two views that acquirers could adopt with respect to family firm targets: the stagnation perspective versus the stewardship perspective. Nevertheless, the term family firm is commonly and too often associated with concepts such as small unprofessional business (Gumpert & Boyd, 1984), autocratic business (Dyer, 1986), stagnant business (Daily & Dollinger, 1992), founder's shadow (Davis & Harveston, 1999), nepotism (Vinton, 1998), path dependency (Chirico et al., 2010), and paternalism and family inertia (Chirico & Nordqvist, 2010). Indeed, a common belief is that family firms are inefficient firms, sometimes perceived as

‘old-fashioned’ and boring (Buckley, 2006). They are depicted as more conservative than their non-family peers by operating at lower levels of innovation (Benson, 1991; Gómez-Mejía et al., 2007; Morck & Yeung, 2003). Accordingly, in the eyes of acquirers, the stagnation view seems to prevail over the stewardship perspective (see Miller et al., 2008). In support of this line of thought, Dawson (2009) found that external investors positively value family firms only when non-family managers are also involved in the management of the company. Non-family managers improve the perceived quality of the family firm's human capital by being associated with a certain level of professionalism and by showing a certain degree of family members’ willingness to delegate authority and be open to outsiders. Moreover, external investors perceive non-family managers to be as professional as themselves (Byrne, 1971; Dawson, 2009; Jackson, Brett, Sessa, Cooper, Julin & Peyronnin, 1991). The above arguments suggest the propensity of external parties to look at a family firm as an unprofessional and low-performing organization. Such negative perception is mitigated only when non-family members – perceived to be more professional – are active in management.

To sum up, while the family firm is a valuable organizational form, and although most family firm’ advantages persist after acquisition if some of the family members are retained in the acquiring company (e.g. valuable resources carefully built over generations by committed family members; family members’ devotion towards the business, human capital; customer relationships), picturing the family firm as an unprofessional and inefficient form of organization drives the acquiring company to underestimate the family firm’ real value and pay less (i.e. acquire at a discount) for it as compared to a non-family firm. In other terms, negative family factors, based on stagnation, prevail over positive ones, based on stewardship and thus the acquiring company attributes a lower valuation to a family firm target compared to a non-family firm target. The underlying assumption is that financial markets are inefficient (Shleifer &

Vishny, 2003). Acquirers do not properly analyze the advantages of potential family firm targets and are disposed to pay a lower price for their acquisition. Also, family firm targets have a weaker bargaining position compared to non-family firm targets because of the general and common external investors' perception that family firms are unprofessional organizations. Thus, they are inclined to trade at a discount. These arguments lead us to the following hypothesis:

Hypothesis 1: Acquirers favor the stagnation perspective rather than the stewardship perspective and thus pay less (i.e. acquire at a discount) for a family firm target than for a non-family firm target.

METHODS

Data Collection

To collect the data for our study, we first identified all acquisitions of medium-large privately-held companies belonging to the Food&Drink industry in Western Europe, on the Mergermarket database between 2000 and mid-2008 for which the necessary historical financial data were available. Privately-held companies are owned by a relatively limited number of shareholders and are not traded on a public stock exchange (Blackman, 1995). Our privately-held company dataset includes both family and non-family firms. While the former have families as major owners, the latter are organized as cooperatives (a common organization structure for the Food&Drink industry), held by individual entrepreneurs, private equity and other non-publicly-listed owners.

Some relevant information regarding our dataset is provided here. First, the choice of the Food&Drink industry was motivated by the following reasons. The Food&Drink industry has an intense consolidation activity to supply enough observations (i.e. acquisitions). The Food&Drink

industry has also been found to include a large number of family firms, thus facilitating data collection (see e.g. Miller et al., 2007; Villalonga & Amit, 2006). Moreover, focusing our attention on a single industry enabled us to neutralize the effect of industry on our final results. Second, most previous research on family firm' performance has focused on publicly-listed firms, although the majority of companies worldwide are actually in private hands (Sciascia & Mazzola, 2008). Our study instead analyzed privately-held companies, thus focusing on the understudied segment of privately-held family firms involved in acquisitions. This also allowed us to avoid differences in valuation between privately-held and publicly-listed companies (i.e. liquidity discount) (Benninga & Sarig, 1997; Koeplin et al., 2000). Third, we omitted all acquisitions in which the target was a missing data for the enterprise value because this would have prevented us from calculating any of the necessary measures. Furthermore, we excluded all targets with negative operating profits¹ (Damodaran, 2006; Liu, Nissim & Thomas, 2002).

As mentioned before, a more conservative and accurate definition of family firm assumes the family (composed of multiple family members) to have a substantial ownership stake (51% or more of equity owned by the family) and at least two of its members in key management positions (Chirico & Nordqvist, 2010; Miller et al., 2007; Westhead & Cowling, 1998; Zahra et al., 2007). A family firm target was defined as such in our dataset if the two conditions mentioned above were satisfied. In particular, at least 51% ownership stake was in the hands of the family and at least two family managers were involved in the business before the acquisition. Finally, to maintain to some extent a certain degree of family influence after the transaction, we tried our best to focus our attention on those acquisitions in which one or more family members were retained in the firm after the acquisition, thus continuing an active role in the management

¹ More information is available from authors upon request

of the company. This is especially relevant in the Food&Drink industry where most of the product-making knowledge is tacit and resides in individuals (Makri et al., 2010).

These selection criteria resulted in a dataset of 73 pairs of family and non-family firms. The sample size is comparable to previous acquisition studies based on the matched-pairs methodology (see e.g. Hotchkiss & Moradian, 1998; Koeplin et al., 2000). Specifically in our study, 59 acquirers positively answered our question of whether or not they retained one or more family members in the company after the acquisition. The remaining 14 acquirers preferred either not to answer at all or explicitly indicated that the company was not authorized to disclose confidential information. Recognizing these differences, we ran the analysis first with all 73 pairs of companies, then with the reduced dataset of 59 pairs of companies, and finally with a sub-dataset including only the companies in which at least two family members were retained in the new company. The latter is obviously the case in which family firm' characteristics are more persistent after acquisition based on the stewardship perspective. Observing that results from the full dataset did not change significantly from that of the restricted datasets, we finally used the full dataset of 73 pairs of companies for our analysis.

Given that most family firms are privately held and usually not obliged to disclose private information, it is extremely difficult to obtain reliable financial information on family firms (Wortman, 1994). The dataset used in this study represents a 'unique' collection of data, having family firms as target companies and financial information regarding their valuation at the time of acquisition. Table 1 depicts the country of origin of targets and acquirers. 36% of family firm targets and 40% of non-family firm targets are from the United Kingdom. The prevalence of the deals coming from this country can be explained by the higher propensity of UK companies to disclose financial data (Arruñada, 2008).

<<Insert Table 1 about here>>

Matched-pairs Approach

We adopted a matched-pairs research design in our study which allowed us to systematically compare family and non-family firms with a similar profile (Allouche et al., 2008; Westhead & Cowling, 1998). This method has already been used in previous mergers and acquisitions studies (Hotchkiss & Moradian, 1998; Koeplin et al., 2000) and in family-firm studies (Allouche et al., 2008; Jorissen, Laveren, Martens & Reheul, 2005; McConaughy, Matthews, & Fialko, 2001; Miller et al., 2007; Mishra, Randoy, & Jensen, 2001).

We established pairs of businesses (one family, one non-family) operating in the Food&Drink industry that matched in their size (in terms of sales and assets), geographical area, year of acquisition and products. Specifically, to confirm that the effect of size was neutralized (see Allouche et al., 2008; Koeplin et al., 2000), we performed a t-test analysis which, as expected, reported no significant differences between family and non-family firms in terms of sales (family firms: mean 123.88, median 47.18; non-family firms: mean 190.34, median 65.35; ns). Also, a non-significant result was obtained for assets (family firms: mean 114.00, median 29.75, non-family firms: mean 162.15, median 31.56; ns).

Multiples

Multiples have been used as measures of value in this study. Penman (2004) defines multiple as the ratio of a market price variable (such as the stock price, the market capitalization, or the whole enterprise value) to a particular value driver (such as earnings, revenues, or the work force) of a firm. Enterprise value is defined as the value of the target company as a whole. It is calculated by adding together the implied equity value and the net debt of the target company² (Mergermarket, 2009). Multiples are considered to be a standard technique employed by

² The implied equity value is the value of the entire outstanding share capital of the target company as valued by the acquirer. This value always represents 100% regardless of what stake is actually being acquired. The net debt is equal to all interest bearing debt minus cash and cash equivalents.

investment professionals. Indeed, 90% of equity research valuations and 50% of acquisition valuations use some combination of multiples and comparable companies (Damodaran, 2002; Koeplin et al., 2000). In particular, multiples have been shown to result in the most accurate valuations when the companies are chosen on the basis of industry (Alford, 1992) as we have done in the present research. Multiples prove especially important for the valuation of relatively stable sectors such as the Food&Drink industry (Demirakos, Strong & Walker, 2004).

To compare the mean of multiples between matched pairs of companies, the t-test procedure was adopted (see Allouche et al., 2008; Koeplin et al., 2000; Westhead & Cowling, 1998). The multiples' approach has been described by Damodaran (2006) in the following way. First, comparable assets that are priced by the market are found (i.e. acquisitions of comparable companies). Second, enterprise values that emerge from the market prices are scaled to a common variable to generate standardized prices for comparability (i.e. the enterprise value is divided by a relevant accounting measure). Third, standardized values are adjusted for differences across companies (e.g. industry, size, country, year and so forth).

EBIT and EBITDA Multiples

Despite the extensive use of multiples in valuation, there is no consensus on the use of any particular multiple (Lie & Lie, 2002). In our study, we specifically used two multiples that are often applied in mergers and acquisitions analysis: EBIT multiple (i.e. Enterprise Value/EBIT) and EBITDA multiple (i.e. Enterprise Value/EBITDA) (see e.g. Hotchkiss & Moradian, 1998; Koeplin et al., 2000). In fact, when the acquisition involves the whole business (versus just the equity in the business), it is recommended to examine the value of the firm as a multiple of the EBIT and/or the EBITDA (Damodaran, 2006). They are two valuable measures of a firm's cash flow, based on two different measures of earnings: Earnings Before Interest and Taxes (EBIT) and Earnings Before Interest, Taxes, Depreciation and Amortization of intangibles

(EBITDA). These two measures were selected rather than after-tax earnings because the values of EBIT and EBITDA are both independent of the capital structures (i.e. the mix of debt and equity) of the acquired companies. In contrast, the earnings (i.e. profits after tax) figure reflects the capital structure of the company because earnings are computed after interest expenses and taxes. Hence, two companies with identical profit streams may have different net earnings ratios due to differences in their capital structures. Thus, it is more appropriate to use a multiple based on earnings before interest and taxes to compensate for the differing capital structures of the two firms. Both EBIT and EBITDA provide a measure of company cash flows available to service debt and pay dividends. The difference between the two is that EBIT is computed net of depreciation, which is a non-cash expense, whereas EBITDA adds back depreciation (Damodaran, 2006; Koeplin et al., 2000).

Additionally, EBITDA is the most frequently used multiple and is considered the most appropriate measure to value a company. Indeed, it is often used in company reports and brokers' calculations in both Europe and the US. For instance, Kim and Ritter (1999) used several multiples for the valuation of initial public offering matching companies (i.e. P/E, market value to book value, price to sales, enterprise value to sales, and enterprise value to EBITDA). However, they found that the EBITDA multiple resulted in the most precise valuation. Interestingly, Lie and Lie (2002) have also demonstrated that the EBITDA multiple should be preferred even to EBIT, because depreciation expenses distort the information value of earnings. Moreover, EBITDA multiple is a more suitable measure in mature industries such as the Food & Drink industry (Fernández, 2001).

Following the method used by Koeplin et al. (2000), the family firm discount or premium in this study was estimated, as follows:

$$\text{Family firm Discount} = 1 - (\text{Family firm Multiple} / \text{Non-Family firm Multiple})^3$$

RESULTS

The descriptive statistics and correlations of the study's variables are presented in Table 2. The family firm discount or premium is shown in Table 3. The EBIT multiple produced a statistically non-significant result. But, when examining the EBIDTA multiple that is the most appropriate measure to value a firm, our findings indicate that family firm' multiples are lower than those for non-family firms. Specifically, external investors acquire family firm targets at a moderately statistically significant discount relative to comparable non-family firm targets (discount mean: 16%; discount median: 5%; $p < .10$). That is, non-family firms are valued higher relative to comparable family firms. Hence, for two comparable businesses (one family, one non-family) with the same EBITDA figure, buyers would pay less (i.e. acquire at a discount) for a family firm than for a comparable non-family firm, thus confirming our hypothesis (see Table 3).

<<Insert Table 2 about here>>

<<Insert Table 3 about here>>

However, given the difference in results obtained with EBIT and EBIDTA multiples, as mentioned before, it is important to underline that EBITDA multiple is preferred over the EBIT multiple in the academic and practitioner communities (see e.g. Fernández, 2001; Lie & Lie, 2002) The practical importance of the EBIDTA multiple is further confirmed by the existence of an index provided by Argos Sodic & Epsilon Research that measures the evolution of European private mid-market company prices via EV/EBITDA multiple (Argos Sodic, 2010). The index provider explains: "We think this multiple [EBITDA multiple] is the most suitable for a European index as it is not impacted by the target's financial structure nor by its policies

³ A negative family firm discount reflects a family firm premium.

regarding depreciation and provisioning (which vary in time and between countries). It is also the closest readily available proxy for operating cash flow". (Argos Soditic, 2010, p. 3)

As concerns our dataset, to further confirm the accuracy of the EBIDTA multiple over the EBIT multiple, and the statistical significance of our result, we compared the coefficients of variation (standard deviation divided by the mean) of the two multiples. EBIDTA multiple appears to have a much lower value of this coefficient (see Table 4). This indicates that there was more consensus about the value of EBIDTA multiple than about the EBIT multiple in acquisitions included in our dataset.

<<Insert Table 4 about here>>

Additionally, it is worthy to note that by running the analysis first with all 73 pairs of companies, and then with the reduced datasets (see data collection), results did not change substantially. If there is no observable difference in the result when zero, one, or more than one family member are retained in the firm after the acquisition, then retaining family members does not bring any advantage from the acquirers' point of view. If the acquirers value family firms at a discount even if they retain family members (as it is in 59 acquirers out of 73), it indicates that they do not appreciate the family firm' advantages that can be transferred by the retained family members. This further supports our hypotheses⁴. Finally, to make sure that our result did not reflect poorer performance of family firm targets, we also ran a t-test to compare the EBITDA and EBIT margins (i.e. EBITDA/Sales and EBIT/Sales) between family and non-family firm targets. The differences in the margins' means were not statistically significant (EBITDA/Sales: Family 13.73%, Non-family 13.94%, ns; EBIT/Sales: Family 9.22%, Non-family 9.16%, ns), thus allowing us to conclude that family and non-family firms have the same levels of performance as measured by margins (see Baliga, Moyer, & Rao, 1996).

⁴ We thank one of the anonymous reviewers for this insightful comment.

DISCUSSION

In the present study we explored the overlooked topic of valuing family firms in the context of acquisitions. Specifically, our objective was to shed light on the valuation of family firm targets compared to non-family firm targets. We argued that acquiring companies often perceive family firms as unprofessional and inefficient organizations, thus negatively affecting their valuation compared to similar non-family firm targets.

When examining the EBIDTA multiple our empirical analysis confirmed our hypothesis that acquirers favor the stagnation perspective rather than the stewardship perspective and thus pay less (i.e. acquire at a discount) for a family firm target than for a non-family firm target. Also, although the EBIT multiple produced a statistically non-significant result, it offers some interesting insights. Indeed, it appears that EBIT of both family and non-family firms are valued similarly (Koeplin et al., 2000) which implies that acquirers fail to discriminate between family and non-family firm targets. In light of this result, we may speculate that acquiring companies are unable to recognize the advantages associated with a family firm target compared to a non-family firm target.

Contributions

Some contributions emerge from our study. First, the present research contributes to filling the gap in the family firm literature regarding the study of valuation of privately-held family firm targets in the acquisitions context (see Basu et al., 2009; Mickelson & Worley, 2003; Steen & Welch, 2006). Our study indeed represents the first empirical research to shed light on the valuation of family firm targets compared to non-family firm targets, showing through the EBIDTA multiple that acquiring companies pay a lower price for a family firm target.

Second, the academic and business communities have often encouraged family-firm scholars to rely more on a matched-pairs methodology to develop comparable analysis between family and non-family firms (Jorissen et al., 2005; Westhead & Cowling, 1998). We adopt this method in our study and use two well-known and commonly used multiples (i.e. EBIT and EBIDTA multiples) that have not been employed in family firm studies to date. Further, following the study of Westhead & Cowling (1998, p. 33), adoption of the matched-pairs methodology enabled us to discover “real” differences rather than “sample” differences between family and non-family firm targets.

Finally, to the best of our knowledge, the dataset used in this study represents a ‘unique’ collection of data; it comprises of family firms as target companies, and, despite the difficulty in obtaining financial information for family firms, contains a set of family firms whose financial information at the time of acquisition was disclosed.

Limitations

Several limitations should also be noted. We argue that a family firm is a more solid organization compared to a non-family firm given that family members invest greater resources in employees’ training, customer relationships, research and development, and company reputation (see Chirico et al., forthcoming; Miller et al., 2005; 2008). However, although we did our best to ensure that the data reflected a certain degree of family influence after the transaction (see methods), our data did not allow us to fully investigate whether family firm’ characteristics are effectively persistent after acquisition. The present gap needs to be addressed in future studies on acquisitions and valuations of family firms. Although we are aware of the difficulty in achieving this goal, building a larger dataset including family firm targets in which multiple family member managers are retained in the active management of the acquiring company, will

help in this direction. In such case, post acquisition performance when the target company is a family firm versus a non-family firm should also be examined.

Further, given the data limitation, we were unable to match our companies for earnings growth⁵. However, Alford (1992, p. 107) obtained evidence that, if controlled for industry type, additionally controlling for earnings growth in the analysis does not reduce valuation errors. In other words, “industry appears to be a good surrogate for the component of...earnings growth related to multiples”.

Finally, the generalization of our findings remains limited to the specific industry and geographical areas on which our dataset was built.

Research Implications

The present article may be regarded as a point of departure for guiding and pushing forward further research. First, given that acquisitions are an important part of the business process of redeploying resources into more productive uses (Ahuja & Katila, 2001), more research should be directed to how family firm’ resources can be effectively integrated into the acquiring company, and whether the process may be facilitated when the acquirer is also a family firm (Feito-Ruiz & Menéndez-Requejo, 2010; Miller, Le Breton-Miller & Lester, 2010). Recent studies argue that within an inter-firm cooperation, when both parties involved are family firms, similarity in the family status provides a contextual understanding (Chirico et al., forthcoming). Both parties benefit from complementary resources, shared levels of commitment and similar appreciation of socioemotional wealth, thus leading to a competitive advantage (Stockmans et al., 2010). Hence, family-firm acquirers could be more willing to pay a premium for family-firm

⁵ We were able to collect information on earnings growth only for 47 observations for family firms and 37 for non-family firms. As expected, after performing the t-test, the mean growth rates of family and non-family firms resulted to be statistically insignificant.

targets, as they may be better suited to leveraging synergies based on family-specific common resources⁶.

Second, although most previous studies confirm that family firms perform better than non-family firms, we admit that this may appear somewhat unrealistic and not general to all family organizations that are heterogeneous entities (Chirico & Nordqvist, 2010; Chirico et al., 2010; Westhead & Howorth, 2007). Future studies should detail to what extent such a superior performance of family firms exists, especially when acquirers need to evaluate potential family versus non-family firm targets. Following the same line of thought, several questions require further exploration. For instance, is it enough that a family firm is a solid organization at the time of acquisition for acquirers to pay a premium compared to comparable non-family firms? To what extent and under what conditions do idiosyncratic family characteristics persist after acquisition? And, even though Miller et al. (2008) did not find support for the stagnation perspective, do the possible negative aspects of a family firm underlined by the stagnation perspective, such as conservatism and nepotism, disappear once the family firm is acquired in the new company? Future research clearly needs to be channeled in these directions.

Third, with few exceptions (see Miller et al., 2008), most of the empirical results on which we base our theoretical section stem from the analysis of large and public firms. On the contrary, although our dataset is composed of medium-large companies, these companies are privately-held. Future studies may replicate our work on a dataset of public companies and find out whether results would change for public organizations.

Fourth, accounting measures of value may be also a possible line for future research. For example, scholars may further explore whether difference in multiples we found can be also

⁶ We thank the editors for this helpful comment.

attributed to differences in accounting practices in family versus non-family firms (Cascino, Pugliese, Mussolino, & Sansone, 2010; Yang, 2010).

Finally, scholars may take into consideration the quantity of transferred shares so as to account for control discount effect. For instance, the control discount effect would be lower if transferred shareholding interest is about 51%, and higher if it is about 100%⁷.

Practical Implications

This research has several practical implications. For the acquirers, we show that family firm targets are undervalued relative to comparable non-family firm peers (see EBIDTA multiple's result). We argue that their 'real' value is not recognized by the acquirers. The typical due diligence processes in mergers and acquisitions commonly focus on financial health (Hitt et al., 2001) and rarely extend beyond to identify special knowledge stocks held by targets (Makri et al., 2010). Consequently, if family firm' idiosyncratic family knowledge or other positive characteristics prove significant in a specific target, this may provide a unique investment opportunity for acquiring companies. Instead, the acquirer tends to underestimate the family firm target's value and is inclined to pay less for a business whose value may be in fact higher, and thus risks losing valuable investment opportunities when the family-firm target is averse to selling at a lower price.

Acquirers also need to understand that a part of target company's managers should be retained in the acquiring company, especially when the target company is a family firm with members who possess idiosyncratic knowledge and values that are hard to imitate or acquire elsewhere (Chirico, 2008; Chirico & Salvato, 2008; Chirico & Nordqvist, 2010). The key is to find target firms with complementary human capital (i.e. knowledge stocks) that remains and

⁷ We thank one of the anonymous reviewers for this insightful comment.

becomes part of the main company. In doing so, the process of recombining existing resources with external resources gained via acquisition can be quicker and easier after the acquisition.

For family firm owners, we showed that their firms are likely to be assigned a lower value than they are worth. The negative consequence for the family firm target is evident: it gets less money than it is worth. Hence, family firm targets need to send positive signals to their acquirers to mitigate the general negative perception that the potential acquirers may have regarding the family organization form. They need to explicitly prove the solidness of their firm, given that such firm was built and managed to last long. Instead, family firms are commonly characterized by a low level of transparency and managed with a “veil of secrecy” (Castillo & Wakefield, 2006, p.49). Moreover, family firm targets need to persuade acquirers that their advantages will persist. This goal may be achieved for instance by retaining multiple knowledgeable family managers in the company, by having in place long-term customer contracts, by agreeing to accept a part of acquisition payment upon reaching some milestone (e.g. revenue target), or by quantifying and reporting intangible family-based resources to third parties, and so forth.

In conclusion, we hope that this research informs, extends and encourages future work on family firms’ acquisitions and suggests changes in the managerial way of thinking when a family firm target is involved in the acquisition process.

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TABLES

Table 1. Country of Origin of Targets and Acquirers

Country	Family		Non-family	
	Target	Acquirer	Target	Acquirer
Americas	N/A	3	N/A	4
BeNeLux	7	8	3	3
France	8	6	13	8
Germany	2	2	1	0
Italy	10	4	6	3
Spain	8	9	9	11
UK	26	24	29	27
Nordic Countries	8	8	6	7
Others	4	9	6	9
Unknown	0	0	0	1

Table 2. Descriptive Statistics and Correlations

	Mean	Std. dev	1	2	3	4	5
1. Assets	138.45	347.02	1				
2. Sales	157.11	314.41	.832**	1			
3. EBITDA	21.34	63.43	.910**	.872**	1		
4. EBIT	14.76	46.2	.882**	.841**	.988**	1	
5. Family dummy	.5	.5	-.07	-.11	-.1	-.09	1

** p <.01; N. 146

Values expressed in USD million (Assets, Sales, EBITDA, EBIT)

Table 3. Family Firm Discount/Premium

	Family firms		Non-family firms		Discount		Sig.
	Mean	Median	Mean	Median	Mean	Median	
EBIT multiple	34.82	16.15	30.58	15.16	-14%	-7%	ns

EBITDA multiple	11.28	9.78	13.39	10.33	16%	5%	*
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*: $p < .10$

ns: Not statistically significant.

Table 4. Coefficient of Variation of the Multiples

	EBIT Multiple	EBITDA Multiple
Family firms	3.12	.52
Non-family firms	1.47	.68
All firms	2.52	.62

CHAPTER 2

FAMILY FIRMS IN THE EYES OF PRIVATE EQUITY COMPANIES

FAMILY FIRMS IN THE EYES OF PRIVATE EQUITY COMPANIES

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Abstract: The succession issue, both intergenerational and outside the family, is a very important topic for family firm practitioners. However, only the former has received significant attention in academia. This paper focuses on the private equity firms, one of the major players in family firm succession field. Our research seeks to answer whether private equity firms distinguish between family and non-family businesses, whether their attitude is positive or negative, and how family firms are perceived by their acquirers. Data was collected through an open-ended questionnaire, analyzed using the content analysis technique, and followed-up with expert interviews.

Keywords: Family business sale, private equity firms, exploratory research, content analysis.

INTRODUCTION

Succession is probably the most challenging task in family firms. Thus, it is not surprising that it is the oldest and the most researched domain in the family firm academia. This topic continued to be prevalent throughout the history of the academic research on family firms, i.e. the last thirty years (Chittoor & Das, 2007). However, very little has been said about succession routes alternative to intergenerational transfer (Goosens, Manigart & Meuleman, 2008). The ownership transfer can take different forms such as sale to a strategic or a financial buyer, management buyout or buy-in, or an initial public offering (IPO). In this paper we address the issue of family firm succession outside the family. We specifically focus on private equity firms, a highly important class of acquirers. The purpose of this study was to determine how investors perceive family firm targets and whether the perception is reflected in their valuation. Our major contribution is that we explicitly assess what family firms' picture private equity firms have and whether this has any consequences on the valuation.

This article is organized in the following manner. First, we briefly review the literature on within-the-family succession and argue why it is important to study alternative succession routes. Second, we explain our motivation behind choosing private equity as potential outside successors. The succession outside the family is an understudied topic with no previous research on private equity investors' perception of family firm targets. Hence, we decided to follow the route of an exploratory research where we did not limit our interviewees to a fixed set of possible responses. Accordingly, we describe the methodology and data collection process followed by the description of respondents. The paper ends with the results, discussion, contributions and limitations of the study. Implications for research and practice are shared in the concluding section.

GAP IN THE LITERATURE

Solving the Succession Issue outside the Family

Succession has traditionally been the most important topic in family business research. The pioneers of family business research understood that a key issue challenging the majority of family firms was succession and thus dedicated studies to this topic (Handler, 1989; Wortman, 1994). Between 1988 and 1997, succession was still a dominant theme according to Dyer and Sanchez (1998) who reviewed 186 articles published in *Family Business Review*. Chrisman et al. (2003) analyzed 190 articles published or presented between 1996 and 2003 and came to the same conclusion: succession was the main topic presented in 22% of all the articles analyzed.

From a practical point-of-view, succession is gaining even more importance in the current demography where baby-boomers, many of whom are family business founders, are starting to approach retirement age and have to confront succession and change of ownership issues (Hickey, 2005). Passing the business on to the family successor depends on the desires and attitudes of each generation (Birley, 1986). The younger generation must be interested in continuing the family business and be able to do so. However, successors may have business interests different from those of their parents. If such circumstances arise, sale of a family firm may be necessary to open up the way to pursue new business opportunities for the next generations as well as to free up some capital. It has been noted that at least one half of the family firms in Switzerland will solve the succession issue by transferring ownership outside the family (Halter et al., 2009). Also in Germany there is a growing trend to sell family firms to third parties. According to a PWC study, 70,000 family firms each year have problems finding a successor, with 30,000 forced to sell (Gow, 2007). In the US, only around 30% of the family businesses survive to the second generation (Astrachan & Allen, 2003; Leach & Bogood, 1999), and only 15% make it to the third (Leach & Bogood, 1999). In the UK, only 24% of the family

businesses manage to be handed over to the second generation and only around 15% to the third (Leach & Bogood, 1999; Bytestart website, 2005). A Deloitte survey of privately-held businesses revealed that merely less than 10% of the UK business owners will never seek an exit and will let the business remain in the family (Cohen, 2009). This means that the majority of family businesses, sooner or later, will change hands; this phenomenon is quite universal and independent of cultural context or economic environment (Lee et al., 2003). Investment professionals have already recognized the potential of these acquisition targets. They perceive family firms to be a very hot market in terms of the number of deals (Reinebach, 2007).

In summary, a change in ownership, whether it be through family succession or sale, is inevitable for all family businesses. Evidence suggests that the latter option prevails over the former. Yet, according to Howorth, Westhead and Wright (2004), academic research focuses almost exclusively on internal succession.

Private Equity Firms

Private equity companies are one of the most important classes of acquirers of family businesses. They invest in unquoted companies at both an early stage (venture capital) and at a later stage (buyouts) (Wood & Wright, 2009). Typically, private equity firms purchase majority of the control of an existing or mature firm (Kaplan & Stroemberg, 2009). These investment vehicles first appeared in the 1980s (Kaplan & Stroemberg, 2009), yet they did not receive wide publicity until their “golden age” between 2002 and 2007. Despite the fact that there is a considerable amount of practitioner literature on private equity, it is a relatively new topic in academia (Bargeron, Schlingemann, Stulz, & Zutter, 2008). Even less developed is the academic research on private equity in family firms. It has been described as being still in its infancy (Achleitner Schraml, & Tappeiner, 2008).

Private equity funds represent 25% of the global M&A activity (Jensen, 2007). Private equity investment firms typically target privately-held companies, many of whom are family businesses. Indeed, over the last twenty years buyouts of privately-held family firms have become widely accepted forms of transferring ownership in firms facing succession problems (Meuleman, Amess, Wright, & Scholes, 2009). Private equity succession route can be particularly suitable for family firms for the following reasons: continued independent ownership of the firm is assured; original management team can stay in place; implicit contracts with employees can continue; and the family has the possibility to stay involved in the firm (Goosens et al., 2008). The Centre for Management Buy-out and Private Equity Research revealed that 38% of European buyouts in 2007 targeted family firms (CMBOR, 2007).

The few studies on private equity investments in family firms (e.g. Achleitner et al., 2008; Howorth et al., 2004) have focused on family firm motivations and the deal process. The most similar research to the current study was undertaken by Dawson (2009) who examined decision-making models used by the Italian private equity investors in their selection of family firms. Our study however deals with a broader range of family firm attributes; this was possible by not restraining private equity respondents to a predefined set of characteristics.

We believe that the topic of family firm succession is highly important and that there is a strong need to close the gap in the literature. From the theoretical point of view, it is important because family business academia and family firms themselves recognize their distinctiveness. But what about third parties, in particular, investors? Do they perceive family firms as a separate class of companies? And what characteristics do they attribute to family firms? From the practitioners' point of view, understanding private equity firms' perception of family firms can benefit both sides. Acquirers can benchmark attitude towards family firms and be better prepared to handle family firm investments. Family firms can understand acquirers' perception, address

weaknesses and potentially achieve a higher valuation. Surprisingly, this topic has been ignored not only by the family firm scholars, but also by private equity scholars who have focused their attention on large public-to-private transaction, leaving the family firm buyout subject understudied (Cumming, Siegel & Wright, 2007). Dawson (2009) argued that private equity professionals among others use family firm specific criteria. However, we found no previous studies which highlighted these criteria. Consequently, our paper has an exploratory character. In the next section, we will explain in more detail the motivation behind our choice to pursue an exploratory research, as well as describe procedure.

METHODOLOGY AND DATA

Exploratory Research

We believe our study is unique since it is the first research that aims to reveal the characteristics of a privately-held family firm from the point of view of its investors. Due to the lack of previous research on the topic, our work is organized in the form of a qualitative study and has an exploratory character. We wanted to obtain a picture of family firms' characteristics, as drawn by the companies that routinely analyze numerous privately-held family firm targets. In general terms, rather than testing a hypothesis about reality, we intended to make a statement about how actors interpret reality (Suddaby, 2006). Qualitative research has been described as appropriate for understanding the world from the perspective of those studied (Pratt, 2009). This type of research is increasingly being published, has won multiple best paper awards in Academy of Management Journal (AMJ) and Administrative Science Quarterly, and was overrepresented in the AMJ's survey about the most interesting management-related studies (Bartunek, Rynes & Ireland, 2006; Pratt, 2009). Although it is gaining popularity, there are still no rigid guidelines on

undertaking qualitative research. Pratt (2009) argues that such a creative nature constitutes its key strength.

A type of qualitative research is open-ended questions that organizational researchers often use to explore, explain, and/or reconfirm existing ideas (Jackson & Trochim, 2002). Open-ended survey responses are often used in organizational research to gather new information about a topic (Sproull, 1988). By asking open-ended questions we did not constrain our respondents to a limited set of answers. While the first two questions mostly yielded a “yes” or “no” answers, the third question, which asked the participants to elaborate on what they felt was particular about the family firm targets, resulted in a richer qualitative data.

Data Collection

A survey of the entire population of private equity firms that acquired Western-European companies between 2000 and 2008 and were covered by the Mergermarket database was conducted from October 2008 to December 2008. The study is based on 14 phone interviews and 140 written responses, followed up with 5 face-to-face and an additional phone interview with experts. Dillman (2000) suggests that surveys must be tailored in method and design to suit the nature of the business and the type of information sought, and that an appropriate mixture of communication modes such as mail, e-mail, Internet, telephone, and interview may be necessary to reach a difficult-to-access population.

Questionnaires were sent to several locations for any private equity firm, resulting in 154 responses representing 138 private equity firms. The number of private equity firms worldwide is approximately 2,140 (Thomson Reuters, 2007). Thus, this research represents opinions of about 6.4% of private equity firms globally. The European Private Equity and Venture Capital Association counts 950 members; the respondents to our survey constitute about 14.5% of all European private equity firms.

Every e-mail was personalized to achieve a better response rate (Heerwegh, 2005): a personal salutation was included, and a local language text was inserted when possible. Respondents were presented with a definition of a family firm and then asked three open-ended questions. Please refer to the Appendix for the questionnaire.

Phone interviews were mostly conducted in English. The proportion of languages represented in the written responses is as follows: Italian (2.9%), French (12.1%), German (22.1%), and English (62.9%). The respondents hold senior positions in their companies. Most of them are investment managers or directors, but a large portion of responses are from partners, managing directors and CEOs. There are only 13 female respondents in the sample (8.4%). Such small proportion is representative of the population. Female professionals represent less than 10% of senior-level executives and deal-makers in the traditionally male-dominated field of private equity (Elizabeth Falk, founder of the Women's Private Equity Summit, 2008). Also, 7% of the respondents have a PhD degree.

Content Analysis

To analyze the final question concerning family firm characteristics we employed the content analysis technique. This class of methods lies at the intersection of the qualitative and the quantitative approaches (Duriau, Reger, & Pfarrer, 2007) and has been described as appropriate for rigorous exploration of many important but difficult-to-study issues of interest to management researchers (Carley, 1993; Morris, 1994). Exploratory and interpretive research is more likely to rely on primary data such as interviews, field notes, videotapes, and open-ended questions to surveys (Duriau et al., 2007).

We used the emergent coding technique. Emergent coding is defined as an approach to classify individuals' open-ended responses whereby a coding scheme is established after collecting all responses.

We adopted a four-stage interpretive approach to the manual classification of open-ended responses suggested by Taber (1991). In the first or the analytic stage, both researchers identified the themes. In the second or the inductive stage, we separately sorted and re-sorted themes into categories in such a way that all the themes in one category had some commonality and were different to those in other categories. The next stage or the interpretive stage involved discussions. Here, we aimed to refine categories until there was an agreement about the final set. Eleven categories were developed. In the last or the verification stage, we verified if categories were clearly defined and if they were distinctive from one another. In case of a disagreement, the theme was discussed and then assigned into a category. We made sure that each of us clearly understood every category.

As a next step, we conducted systematic content analysis by applying coding scheme (list of categories) to the responses (Neuendorf, 2002). Coding was performed autonomously by both authors. In coding the interviews, we assigned a maximum of three codes to each piece of related sentence fragment or a “thought unit” (Currall, Hammer, Baggett, & Doniger, 1999). We allowed for multiple codes because we found that even small thought units could easily be assigned to multiple categories (Klein, Ziegert, Knight, & Xiao, 2007, approached this issue in the same way). Prior to analyzing data, all discrepancies in coding were reconciled. We discussed all the points where we had divergent opinions and finally came up with frequencies for each category.

To further validate our findings, in-depth expert interviews were carried out. The goal of this step was to clarify and broaden our understanding of private equity firms’ perception of family firm targets. During this phase, we interviewed 6 additional private equity professionals. The interviews lasted 30 minutes on average. We explained to interviewees that we had conducted prior research on private equity firms’ perception of family firms and were interested in knowing whether our preliminary conclusions were on target. We gave interviewees brief

verbal and written overviews of the tentative conclusions drawn from the previous phase of the research. We then explained to and asked the interviewees, “We want to know if we have this right. What do you think of this description of family firms? Is there anything you would change or amend?” Verifying one’s findings and interpretations with the incumbents of the setting is a commonly recommended strategy for an exploratory research (Glaser & Strauss, 1967; Perlow, 1998; Pratt, 2000).

Experts agreed to 68% of our family firm characteristics. We came up with this number by independently reading interview transcripts and registering whether experts agreed to each of our categories. During the interview we did not limit ourselves to the discussion of the list of characteristics of a family firm target (i.e. categories). We also asked several questions designed to yield additional information, to understand relative importance of different characteristics, and to discuss our preliminary analysis of the results. All face-to-face interviews were audio-taped and later transcribed verbatim.

DISCUSSION

Results

Exactly one half of the respondents stated that they distinguished between family-firm and non-family firm targets. However, only one third replied that this difference influenced the price. In most cases, this perception had a negative influence on valuation of the family firm targets. One of the interviewees commented, “...overall this means family businesses often trade at a significant discount, but this is not because they are family businesses...it is because family businesses often adopt business and management practices which can only work in a family environment” (#148). The private equity companies which did not observe any difference often

commented that they use general valuation criteria, and whether a target is a family or a non-family firm does not have any significance. This is in line with the findings by Dawson (2008) who stated that private equity investors attribute greater importance to criteria that are not family-related.

The following table presents the most common themes and their frequencies.

<<Insert Table 1 about here>>

From the table it appears that family firms are generally perceived to be risky investments. Also, the process of acquiring family firms differs from that of non-family firms. The next table presents evidence for each of the characteristics.

<<Insert Table 2 about here>>

Analysis

We have decided to focus on the main issue: the riskiness of family firm targets. Private equity firms perceive family firms to be riskier than non-family companies. Higher riskiness surfaced as the main theme throughout the interviews. The riskier an investment, the lower the price an investor is willing to pay for any expected return identical to that offered by a less risky investment. As expected, the correlation coefficient between the characteristic “Higher risk investment” and the question “Do you have a reason to pay more or less for a family firm target?” turned out to be negative and significant (-0.461, $p\text{-value} < 0.05$). This suggests that those who believe family firms to be riskier investments tend to assign lower values to these firms. In other words, private equity firms adjust for risk by lowering price. However, this does not imply that if an investor analyzes a potential target and flags it as a family firm he or she would automatically apply a discount. This finding is about family-firm specific risks that could potentially influence the valuation. Apart from adjusting for the riskiness with price, counterparty risk can be mitigated by a proper deal structure. One of the private equity professionals

commented, “[Family firms] can ... cheat the books and show profits that are not there in reality. The deal can be structured in the following manner to avoid this. If the price of a company is 100, you give to the family 85 and put 15 in an escrow account. If after 6 months, the results are like they have to be, the family gets its 15. If you propose such a deal to a family and then you see them nervous, you know that there is something wrong.” (#118) Experts commented on the differences between an escrow account (established to mitigate the risk of untrue representations and warranties made by the seller) and an earn-out provision (established to assure that the firm will achieve financial goals as promised by the seller). Whereas escrow accounts are used to avoid risks connected to the firm’s past and present, earn-outs are linked to the future. The latter provision serves to bridge the gap between buyer’s and seller’s valuations of the target’s future profitability. Another interviewee mentioned the importance of keeping a minority ownership in the family during the period of investment: “We would buy 100% in case of a big corporation spin-off / secondary [buyout], but between 75% and 90% in case of a family firm. The family has to hold the remaining 10-25% in order to be stimulated to collaborate with the PE.” (#120) One of the respondents mentioned the inclusion of a “broken deal” clause in the letter of intent since, according to some of the interviewees, families are more inclined to change their minds midst transaction. It would be fair to note however that these conventions are not exclusive to family firm buyouts. For example, it is common for an acquired firm’s management to get an equity stake in portfolio companies (Kaplan & Stroemberg, 2009). Also, earn-outs have always served as a risk management tool in private equity deals (Parnass, 2009).

Regarding other characteristics, several experts noted that some of them were not really family business related, but were rather associated with the size of the business. One of the experts noted, “That is more the question of scale” (E2). In fact, academic literature often finds small businesses to demonstrate the same characteristics that private equity professionals used in

order to describe family firms. For example, poor managerial competence was found to be more common in small businesses by Jennings and Beaver (1997). This can be partially explained by lower levels of training and development (Loan-Clarke, Boocock, Smith, & Whittaker, 1999). Watkins (1983) found that small business owners do not see the need to implement even the most basic management practices. Also, there is a lower need for MIS in small firms since the owner-manager is often not convinced of necessary procedures to monitor performance (Fuller-Love, 2006). “Dominance of single individuals”, one of the characteristics suggested in the study, is also an issue faced by small firms since the owners often wish to retain control of all aspects of the business (Fuller-Love, 2006). To some extent, the characteristic “Family before business interests” is also found in small businesses. According to Ang (1991), small firms show higher integration of personal and business affairs than large companies. Because of these similarities, private equity professionals may equate family firms to small businesses. To some extent, this may be connected to the empirical evidence that although family firm buyouts contributed to 38% of the number of all European buyouts, they only represented 11% of the total value. This further underlines the fact that family firms are generally smaller than other types of buyouts (Scholes, Wright, Westhead, Bruining, & Kloeckner, 2009). Finally, while not necessarily a characteristic of a small business, lower growth has been documented to take place in family firms led by either the subsequent generations or the older entrepreneurs (Westhead, Cowling, & Howorth, 2001). Inclination to preserve wealth and aversion to risk connected with exploring new wealth-creation opportunities are probably the main reasons for this (Goossens et al., 2008).

Most family firm characteristics that emerged from the research seem to be indicative of weaknesses. However, these weaknesses correspond to the measures that active investors such as private equity firms undertake. Jensen (1989) and other proponents of leveraged buyouts argue that private equity firms improve firm operations and create economic value by applying

financial, governance and operational engineering. Consequently, the shortcomings of family firms may be overcome through active management by the private equity firm. This, in turn may represent an untapped potential. Scholes et al. (2009) noted that as a precondition for investment by a private equity firm in a buyout, they need to perceive that there would be upside gains from investing in the deal. Scholes and colleagues further noted that private equity practitioners indeed appreciate that some private family firms have an untapped potential. Accordingly, the issue of lack of management information systems can be solved by their introduction. Indeed, the level of professionalism in a family firm was found to increase following a buy-out (CMBOR, 2007). The financial inefficiency problem can be settled by reorganizing operations. Previous literature found private equity-backed transactions to streamline organizational processes, reduce workforce and decrease unit costs (Harris, Siegel, & Wright, 2005; Meuleman et al., 2009; Wright, Hoskisson, & Busenitz, 2000). As to the issue of lower levels of growth, previous literature has suggested that buyouts stimulate growth opportunity realizations (Meuleman et al., 2009; Wright et al., 2000). This goal is often achieved by taking on more debt. Lower levels of debt in family firms, as documented in previous literature (Gallo & Villaseca, 1996), should be a motivating factor for private equity investors. Since a buyout is typically financed with 60% to 90% debt (Kaplan & Stroemberg, 2009), private equity firms can exercise more liberty in implementing the leverage in businesses that had incurred lower levels of debt in the past.

The only weakness that is not easily corrected is poor management, especially if managers occupy dominant positions in the firm. There is a considerable amount of human resources risk involved in such transactions. Krishnan, Miller and Judge (1997) empirically found that the lower the turnover among the acquired firm top management team, the better the post acquisition performance. Hence, private equity firms will not feel comfortable acquiring poor management team which would need to be substituted quickly. However, even this problem may be partially

resolved by enhancing management team with more competent members. Private equity firms may provide resources and capabilities that management teams lack (Meuleman et al., 2009; Zahra & Filatochev, 2004) in the form of financial and strategic advice (Sapienza, Manigart, & Vermeir, 1996). They may also provide contacts and professional development of management (EVCA Report, 2005). Previous research found that private equity investors do not hesitate to fire poorly performing managers (Kaplan & Stroemberg, 2009). One third of such managers are replaced within the first 100 days while the rest are replaced at some point during the deal (Acharaya, Hahn & Kehoe, 2009). Private equity firms may also specify contractual restrictions on the behavior of remaining managers (Wood & Wright, 2009).

Conclusions

Family firms play a crucial role in economies around the world. A large number of these firms are facing succession issues. However, many do not have the resources and capabilities to go through with intergenerational succession. Surprisingly, the topic of succession outside the family has been understudied; however, it seems to be gaining momentum. Private equity firms represent an important class of acquirers. Their role in family firm succession has been recognized by regulators who have concluded that buy-out financing has a potential to facilitate generational change in family firms (European Commission, 2006). Without any doubt, the topic is also interesting to practitioners. The fact that 161 busy private equity professionals agreed to devote their time to the research speaks in favour of extending further work in this direction. Academic research has consistently found the salience of the issue to be consistently associated with higher response rates (Baruch, 1999; Cycyota & Harrison, 2006; Heberlein & Baumgartner, 1978; Roth & BeVier, 1998; Tomaskovic-Devey, Leiter, & Thompson, 1994). Therefore, the topic of private equity investments in family firms merits occupying its well-deserved place in academic minds and journals.

Our survey results revealed that one half of the private equity professionals would flag the fact that a potential acquisition target is a family firm. However, this difference between a family and a non-family firm translated into valuation only for a third of interviewed professionals. The ones that would value a family firm differently lean towards negative valuation. To some extent, such inclination is explained by the higher degree of risk attributed to family firm targets. Further research on the particularities of the acquisition process and deal structures would be of interest. Also, studies that focus on mitigating family-firm specific risks as well as enhancing deeper understanding of particular risks need to be undertaken.

Implications for Research

By content analyzing responses instead of having private equity professionals answer via a fixed response format, we were able to elicit information about investments in family firms in greater depth and detail. Our analysis identified numerous issues that can be studied in future research using a combination of quantitative and qualitative research methods, thus increasing the potential to explore the generalization of these results across different geographies and investors. Data collected from open-ended responses are often not intended for analysis but are used for developing other questions (Anderson & Shaw, 1999). We believe that many questions were raised here. Why are family firms perceived to be riskier targets than non-family firms? What can be done to resolve this? Is it because of risk that almost one third of the respondents indicated that they would value the family firm at a discount? Even though correlation between the two attributes in our study clearly showed this, a larger scale research, with a method more suited for quantitative data analysis, should be carried out.

Implications for Practice

More emphasis should be put on the understudied topic of family firm acquisitions. Family firms make up a particular class of acquisition targets, and hence deserve a special approach. Further research will benefit potential family firm acquirers who would be able to better handle investments in family firms. Also, family firms can get a better understanding of how they are perceived by potential acquirers and consequently improve their preparation for the sale process. From the current study, it appears that family firms should increase transparency of their businesses. In part, this can be achieved by introducing management information systems and outlining responsibilities within the firm, a move that would possibly involve hiring an external manager. As previously discovered by Dawson (2009), private equity companies prefer family firms that are professionally managed. Hiring an external manager would not only add to the perception of a firm as being “professionally managed” but would also diminish reliance on single individuals and make investors more confident about smoother transfer of ownership. Scholes et al. (2009) have suggested that involving non-family managers should result in improved efficiency leading to increase in the firm’s value pre-buyout.

Additionally, hiring an external advisor would help both parties drive more easily through the process. Experts who have commented on the topic of lower professionalism displayed by family firms during the acquisition process noted that it is not true that families are less professional sellers, but that they often do not have good advisors. An external party may also help overcome emotions and underline realistic expectations regarding family firm’s worth. In addition, an advisor could help resolve family conflicts before making a firm available for sale. However, the use of prestigious financial institutions and auditors lead to costs that may offset, to some extent, the benefit of reduced underpricing (Hutchinson, 1999).

Contributions

We hope that our findings and conclusions will inspire new studies on private equity investments in family firms as well as on alternative succession routes. For decades, studies on succession have focused on succession from within the family. Given that a large number of families exit their businesses, the topic of alternative succession routes demands further conceptual and empirical analysis. We also believe that our study contributes to the understanding of family firm perception by third parties. Further research on how external groups such as investors and customers view this unique type of organization is justified.

Limitations

Limitations of our research are connected to the methodology adopted in this study, and to the fact that our results may have been subjected to interpretation bias. Coding decisions made by researchers can pose threats to the reliability and validity of the results (Krippendorff, 1980; Seidel & Kelle, 1995). Furthermore, researchers can argue that since our conclusions are derived from self-reported sources, they are not an adequate representation of reality (Dawson, 2009). We would like to argue that our method is appropriate, because of the exploratory nature of our study and also because we were looking to make statements about how actors interpret reality, not about the reality itself. Without doubt, a different method and approach to this topic may bring additional insights and may potentially change some of our conclusions.

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TABLES

Table 1. Family Firm Target Characteristics: Numbers

Family Firm Target Characteristic	Freq.	% of total	% of those who see difference
Higher risk investment	51	33%	66%
Acquisition process & deal structure differ	42	27%	55%
Emotions & intuition	35	23%	46%
Family before business interests	31	20%	40%
Poor management & lower quality managers	29	19%	38%
Poor transparency & need more due-diligence	27	18%	35%
Less MIS and formal structures	24	16%	31%
Complicated shareholder structure & conflicts inside family	17	11%	22%
Dominance of single individuals or very small groups	16	10%	21%
Financially inefficient & lower levels of growth	15	10%	20%
Long-term orientation	12	8%	16%

Table 2. Family Firm Target Characteristics: Evidence

Family Firm Target Characteristic	Evidence
Higher risk investment	<p>"There is risk involved in a family deal that the family takes money, leaves and business stops." (#4)</p> <p>"Businesses with extensive family involvement tend to have greater human resources risks and transition risks than those that have been "more professionally" managed". (#40)</p> <p>"...risk / uncertainty in the decision-making when dealing with family members". (#50)</p> <p>"it tends to be more difficult to implement change in family businesses...so harder to drive out the value". (#107)</p> <p>"...the risk that it will be difficult to change a culture..." (#110)</p> <p>"...risk of hidden facts..."(#125)</p>
Acquisition process & deal structure differ	<p>"A family business sale can be cancelled last minute, because the owning family has changed its mind." (#5)</p> <p>"[Family] is a negotiating tool more than anything, as it gives you certain flexibility with regards to pricing". (#59)</p> <p>"...selling process of a family firm is less public, i.e. it is not conducted through an open auction". (#69)</p> <p>"...selling professionalism is less developed than by corporations". (#99)</p> <p>"...a PE firm can include certain non-cash elements in a transaction which a family values, whereas the actual cash price might be less than what a corporate seller would require...Family firms ... are more interested to understand who they are dealing with... We value having more time to access information, and to have less competition when looking at a particular target.". (#105)</p> <p>"The family has to hold ...10-25% in order to be stimulated to collaborate with the PE. (#120)</p> <p>"Family firm deals are much tougher. You have to give reassurance to the family". (#144)</p>

Emotions & intuition	<p>"The owners of family firms involve more emotions when they decide about the price..." (#12)</p> <p>"Higher loyalty to the company, often more than just financial commitment". (#93)</p> <p>"...non-formal indicators of level of activity and financial health ... (vision of the rhythm of work of employees, the mood of any particular key employee)..." (#108)</p> <p>"...discussion is usually connected with more emotions, more irrational thinking..." (#124)</p> <p>"Families are emotionally involved with their companies: that is why usually the sale of the business would be the last solution for sourcing the money for some other needs". (#144)</p> <p>"The family management knows their company and the industry so well that decisions are often taken following their instinct". (#146)</p>
Family before business interests	<p>"...privilege to family members..." (#55)</p> <p>"...family business ...often sees its interests confused with those of individuals who control it" (#89)</p> <p>"...management that can handle in family and not in company's best interest (e.g. arbitration salaries / dividends)..." (#108)</p> <p>"A family extracts value from the company in form of salaries and using company's assets in family purposes...Families run the business to finance the family". (#118)</p> <p>"...earnings depressed by "family" expenses..." (#151)</p>
Poor management & lower quality managers	<p>"As a rule, I would say family businesses are not as well run as corporates". (#66)</p> <p>"...the management of these businesses is less professional than non-family companies, as management positions tend to not necessarily be filled according to the managerial competence". (#89)</p> <p>"...less 'sophisticated' (perhaps sticking to tried and tested practices)" (#109)</p> <p>"...family managers [are of a] lower quality, because they come to firm on managerial position without recruitment process, so that means it is a big chance they have no adequate qualification, experiences from previous jobs or they are less suitable for concrete position..." (#125)</p> <p>"More often than not feuds and internal conflicts result in a business being mismanaged or decisions being poor or delayed". (#145)</p>
Poor transparency & need more due-diligence	<p>"...a greater potential for the information asymmetry. Once the meeting is finished, the private equity goes home and discussion stops for it, but not inside the family". (#4)</p> <p>"The lack of professional investors means you can see some very strange reporting metrics and processes and often there will be a lot of skeletons in the closet ..." (#41)</p> <p>"We would certainly flag an opportunity if it was a family firm for additional due diligence on the dynamics of the relationships". (#50)</p> <p>"...the distribution of power is usually different from that displayed on the official organizational chart". (#89)</p> <p>"In family firms, one cannot see from financial accounts what the real company's potential is...A private equity has to reconstruct accounts, because actual numbers are prepared for fiscal authorities and do not display the real value...The due diligence of a family firm has to be done with the major degree of suspicion. Families are always smarter than private equities". (#118)</p> <p>"...you always need to be careful with the quality of accounting and controls in family businesses and also at the process for hiring, assessing and promoting people, also need to understand if there will be an impact of reducing the family involvement in the business..." (#148)</p>
Less management information systems (MIS) and formal structures	<p>"...sometimes they have poorly developed management and reporting structures. The reason can be that the owning family had no interest in institutionalized management structure for a long time". (#53)</p> <p>"...they have an insufficient financial reporting systems, lack enterprise reporting systems (e.g. SAP)". (#54)</p> <p>"...in the non-family firms there is more reporting..." (#86)</p> <p>"Flexible structures in the family firm (one person often performs different functions)". (#120)</p>
Complicated	<p>"It typically faces complex structures, especially after many generations" (#54)</p>

shareholder structure & conflicts inside family	<p>"...multiple family members involved there are often different interests of family members or [family branches] in place. This makes a transaction more difficult". (#63)</p> <p>"You try negotiating with a the shareholders when they're all inter-related and you'll soon find out that doing a deal from a family is usually a nightmare...shares spread amongst ill-informed opinionated family members who don't agree that the deal being offered is fair...". (#81)</p> <p>"There are sometimes disagreements between shareholders, for various reasons (often larger than the business) that can complicate or even jeopardize the future of a company". (#83)</p>
Dominance of single individuals or very small groups	<p>"...the dependence on single persons. This is potentially higher by family firms". (#12)</p> <p>"...the change in control is often problematic due to the dominant status of the previous owners." (#90)</p> <p>"...structurally are tailored to a strong leader/patriarch with all the pluses/minuses". (#91)</p> <p>"Family firms are often autocratically run: one person decides everything...Even if an outside CEO is employed, he has to report to the family member, who will take the final decision. The inability to guide the strategic development of a business is often the reason why good CEOs do not want to work for a family firm".(#146)</p>
Financially inefficient & lower levels of growth	<p>"They do not move once a “point of comfort” is reached". (#4)</p> <p>"Family run businesses tend to be less efficient – whether it is on expenses (higher cost); or in strategy (very opinionated and stuck in tradition)". (#7)</p> <p>"Often family firms are not the most aggressive in driving growth". (#101)</p> <p>"Family businesses tend to be more risk adverse and therefore less likely to have the skills within them to make acquisitions or expand geographically". (#104)</p> <p>"I would expect family-owned firms to have more inefficiencies..."(#105)</p> <p>"...often lacked capital to expand internationally which means... untapped expansion opportunities". (#151)</p>
Long-term orientation	<p>"Family firms have a longer history. This means they are more robust, they survived through different cycles". (#4)</p> <p>"They invest enough, because they have a vision on a future". (#39)</p> <p>"...long term view on strategy, trusted partners, often well-invested and property rich which improves asset backing..."(#41)</p> <p>"...better position in their market, because they can follow long-term strategies and take care about the customers not the capital markets".(#48)</p> <p>"...long-term management and hence better quality assets, customer relationship management". (#55)</p> <p>"Family businesses are inherently more durable, stronger, with long-term projects and sometimes longer investment cycles". (#108)</p>

APPENDIX

Questionnaire

Definition: Family firm is a company in which multiple members of the same family are involved as major owners or top managers, either contemporaneously or over time.

1. Do you distinguish between family- and non-family firms when analyzing your targets?

2. Imagine you have two privately-held companies equal in every respect with the only difference that the one is a family firm and the other not: do you have a reason to pay more (positive difference, premium) or less (negative, discount) for a family firm target?
3. What is this difference due to? What particular traits does a family firm have that translate in a premium or discount?

CHAPTER 3

FAMILY FIRMS – RISKY ACQUISITION TARGETS?

FAMILY FIRMS – RISKY ACQUISITION TARGETS?

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Abstract: This study contributes to an under-researched yet highly important topic for both academia and practitioners, the alternative succession routes for family firms. Results of the survey among the US-American private equity professionals revealed that family firms are perceived as riskier targets than their non-family counterparts and that this may influence their valuation. Risk-mitigating measures and other outcomes of the perceptions of family firms as higher risk targets are discussed. Implications for theory and practice are shared in the final section.

Keywords: Family business sale, private equity firms, risk, survey.

INTRODUCTION

Although traditionally family firm literature was almost exclusively dedicated to the topic of intra-family succession and was seeing a sale of a family firm as a failure, finally we can find some academic researchers arguing that both keeping and selling the business could be viable success options for business families (Dana & Smyrniotis, 2010). In fact, a high number of families around the world is actually considering to sell (Halter, Schrettle, & Baldegger, 2009; Gow, 2007; Smyrniotis & Dana, 2006, 2007). One size does not fit all: some families want and can be passed onto multiple generations, while others may be unwilling or unable to do so. In fact, empirical research suggested that some owners may perceive that there are no suitable family members to whom ownership and leadership can be transferred (Wright, Thompson, & Robbie, 1992; Bierly, Ng, & Godfrey, 1999). Accordingly, for some business families an exit can be a positive choice (Birley et al., 1999). Closure of a business should not be equated to a failure. It can be a consequence of retirement, more attractive alternative opportunities, or sale of the business for profit (Stokes & Blackburn, 2001). Often, family business owners use the term “pass along” to mean both transferring ownership to the next generation and selling the firm to pass along the wealth created by the business (Vought, Baker, & Smith, 2008). Although academia finally recognized that a sale of a family firm is a viable option, there is still very little research covering alternative succession routes. Family businesses sale is a part of the universe that is nearly missing from the family business research (Scholes, Wright, Westhead, Burrows, & Bruining, 2007; Vought et al., 2008). It would be fair to cover all the options available to family firms. This need is reinforced by the growing tendency to sell family firms. Investment professionals perceive family firms to be a very hot market in terms of the number of deals (Reinebach, 2007) and 38% of European buyouts in 2007 targeted family firms (CMBOR, 2007).

Additional research would also aid business families in making a decision about which succession route to select and help them prepare for a sale should they choose not to pass the firm on to the next generation. On the other hand, it is possible that acquirers are not aware of distinctiveness of family firms and hence additional research will aid them in better handling their deals.

This paper reports a study of private equity professionals' attitude towards family firm targets and is one of the very few articles trying to understand acquirers' perception of family firms. The objectives of the study were threefold. First, it was intended to further develop the qualitative findings from a exploratory study on family firm targets' perception by private equity firms (Granata & Gazzola, 2010) that was aimed to open up a discussion about family firms as acquisition targets. The most prominent characteristic from the previous study was higher riskiness of the family firm targets. Consequently, a major attention was given to the exploration of this trait, as well as better understanding of its consequences and mitigating measures private equity firms employ. Second, it is hoped that the results will provide members of the private equity community, as well as other financial and strategic acquirers, with an aggregate picture of family firms and in particular outline risks associated with this type of targets. Finally, this study should help selling families pinpoint their weaknesses, take the steps necessary to improve them and consequently be able to negotiate a higher valuation.

METHODOLOGY

Survey is, by far, the most common method of data collection in several fields, and is anticipated to remain such at least for sometime in the future (Aaker, Kumar, & Day, 1995; Chadwick, Bahr, & Albrecht, 1984; Malhotra, 1993; Simsek & Veiga, 2000; Synodinos & Brennan, 1988). Gathering data via surveys has several weaknesses relative to experimental

methods, however it has remained prevalent in the management research due to relatively higher costs and complexities connected to performing experiments and because surveys may be a better fit for many research questions (Simsek & Veiga, 2000). As to Zikmund (1994), if you want to find out what managers are thinking, you need to ask them. The objective of the research was exactly this: to understand what private equity professionals think about family firm targets and how their perceptions influence their behavior (i.e. valuation, length of the process, risk-mitigating measures).

The questionnaire was created using the findings from a previous author's research (Granata & Gazzola, 2010). The study was organized in the following steps. The initial draft of the questionnaire was discussed in-depth during face-to-face conversations with eight experts. This step served a twofold purpose. First, I wanted to examine if respondents understood all the items in the way I meant them to be understood. Second, experts suggested additional items. Although, all the suggestions were very valuable, I only stuck to additional items that corresponded to the purpose of the research. The following individuals were involved as experts: two private equity professionals, one consultant to private equity firms, two family business and one entrepreneurship professors, one private equity post-doc researcher, as well as one professional survey consultant. The questionnaire was then pilot tested in two stages. In the first stage, testing was performed with nine PhD and post-doc students. This time rather than using face-to-face communication, I asked them to fill out questionnaire in the electronic form, the media that I was going to use for the final study. Doctoral and post-doctoral students' comments mostly concerned wording and scale issues and were critical for the final development of the questionnaire. The scale items were then reworded based on their feedback and distributed to the participants of the last testing stage that included 23 undergraduate and MBA participants of the family business course at The Wharton School. This step gave me a glance of what the results

may look like in the actual study. In addition, final version was tested for the time expense. The responses from both pilot tests were not included in the final analyses.

The survey instrument consisted of 13 major questions relating to various family firm targets' risks, risk-mitigating measures, valuation, investment process and familiarity with the family firm targets. Respondents were asked both if they perceived family firms to be riskier than non-family counterparts, as well as a series of questions about types of risk that are possibly connected with investing in a family firm. I also invited respondents to specify the most important risk out of all the proposed, as well as suggest any additional risks that were not listed. Next questions concerned risk-mitigating measures such as certain contractual provisions and various types of due diligence. In line with the previous study, I introduced a question about valuation. Exploratory study (Granata & Gazzola, 2010) on which the current research is based found several family firm characteristics that seemed to be rather weaknesses. However, they appear to be well-matching to post-acquisition improvements implemented by such active investors as private equity firms. This could suggest that family firms may offer an upside potential. To elaborate on this finding, I brought in a series of items connected to investors' actions and asked to what extent these items were relevant. Further questions dealt with the length of process and whether a family firm was rather a turnaround situation. Turnaround firms are defined as ones that were once profitable but are now earning less than their cost of capital (Macdonald, 1992). This item came up after discussing findings from the previous study at an international conference. Presented with rather a negative picture of family firms, participants hypothesized that it may be the case that only "bad" family firms are sold, while the "good" ones stay in family hands. An analogy can be drawn with the venture capital literature. It was noted that adverse selection was an issue: better ventures were presumed to resort to cheaper sources of financing such as debt, while those who were not good enough to obtain the debt financing would

rely on venture capitalists (Koryak & Smolarski, 2008). Finally, a question regarding the degree of familiarity with the family firms closed the survey. Its purpose was to find out whether more knowledge about family firms translated in some particular pattern of answers. However, it should be noted that only private equity professionals with at least some degree of familiarity participated in the research, so there was not too much variability on this item. Indeed, this was the scope of the study: to learn about perceptions of investment professionals who have experience with family firms. Please refer to the Appendix for the full version of the questionnaire.

Answers were measured using a 7-point Likert-type rating scale (i.e. Osgood, Suci, & Tannenbaum's (1957) scale). Although omitting a central point on a scale (i.e. even number of points) eliminates "easy outs" and makes respondents take sides on an issue, offering a middle alternative maximizes data quality. O'Muircheartaigh, Krosnick and Helic (2000) found that in this way the amount of random measurement error is reduced and hence reliability is increased, while the validity of attitude measurements remains unaffected. In addition, respondents may not be able to agree or disagree if they perceive that their opinions are in exact balance, so offering a middle point may indeed provide more honest answers (Fowler, 1995). Scales with 5 to 8 points provided the greatest agreement between people rating the same set of objects and the lowest susceptibility to context effects (Finn, 1972; O'Muircheartaigh et al., 2000; Schwarz & Wyer, 1985; Wedell & Parducci, 1988; Wedell, Parducci, & Lane, 1990). Within 5 to 8 points interval there are two alternatives offering a middle point (i.e. 5- and 7-point scales). The longer one was preferred because a higher number of points allows respondents to have finer distinctions in terms of attitudes and hence should offer more information about differences between people and increase the variance of subject responses (O'Muircheartaigh et al., 2000).

To assist the private equity professionals in making their choices, each point on the scale was named. Hopefully, this also helped enhance consistency in interpretation by not letting respondents assign their own meaning to the value.

Electronic survey was chosen because private equity professionals is a population of executives who is spending a lot of time in meetings or traveling to potential targets, current investee companies and limited partners. An electronic questionnaire can be answered at one's convenience, so for the sake of time constraints of this difficult to reach executives' population this way of communication was preferred. In addition, electronic surveying has several attractive features for researchers such as easy data management, location flexibility, and rapid diffusion (Simsek & Veiga, 2000).

DATA

The whole population of the US-American buyout firms listed on the Private Equity Info website was considered for this study. The survey was administered between March and April 2010. Questionnaire was sent to 1,018 e-mail addresses, 916 of which were personal addresses of private equity professionals. Where there was no possibility to retrieve a personal e-mail, request was sent to a general address of a private equity firm. Although questionnaire was anonymous, I highly suspect that the general address enquiries produced a very low number of responses, if any. More than half of the survey participants contacted me back, but among the answers there was not a single one from private equity firms for which I only had a general enquiry e-mail address. As to Simsek and Veiga (2000), impersonal questionnaires are often thrown away before reaching the person who has the required information, because it is not always clear who should respond. Another reason is that the low-priority request such as participation in an academic study might be filtered out by an assistant receiving the e-mail. In addition, the delivery of 45 e-

mails failed, 17 of them being general and the rest – personal e-mail addresses. Finally, 7 private equity professionals replied that the survey was not applicable to them and 2 refused to participate due to firm’s policies. Consequently, the adjusted number of population to whom enquiries were sent is 879⁸.

A reminder was e-mailed several days before the deadline announced in the first invitation. Multiple contacts with potential respondents may increase the legitimacy of the survey and enhance the number of answers (Kanuk & Berenson, 1975; Porter, 2004).

Only fully administered questionnaires were considered for the analysis. Usable responses were received from 145 private equity professionals yielding an overall response rate of 14.2% (16.5% if the adjusted number of the total population is considered). This response rate can be seen as quite a success since professionals interviewed were on the highest levels of management in their organization. Executives under the current pressures of running an organization were described as having less time and energy to spend on pro bono, low-priority behaviors such as survey completion (Cooper & Payne, 1988). Singh, Taneja and Mangalaraj (2009) commented that researchers seeking responses from executives should be prepared to mail out nearly twice as many surveys as they might plan to use for other populations for their study.

Armstrong and Overton’s (1977) found that late respondents are more likely than early respondents to be similar to non-respondents. Answers were categorized into two sets based on when they were received. MANOVA tests were conducted to examine differences in responses received at different times. No significant differences were found between early and late respondents. Consequently, sample selection bias was not an issue in this study (Kanuk & Berenson, 1975; Sharma, Chrisman, & Chua, 2003).

⁸ 916 personal e-mail addresses – 28 failed personal e-mails – 7 not applicable – 2 refused.

DISCUSSION

Results

Private equity professionals rather agree than disagree that family firm acquisition targets bear higher risk than their non-family counterparts (mean = 4.53 on a 7-point scale from 1 = “Disagree Strongly” to 7 = “Agree Strongly”). The two most important risk types are management transition risk and culture transition risk (mean values 5.84 and 5.56 respectively). Both of them also have the two lowest standard deviations meaning that there was quite a high level of agreement among survey participants.

<<Insert Graph 1 about here>>

An open-ended question aimed to reveal any additional family firm targets’ risks. Some of the comments actually confirmed the importance of the management and culture transition risks. One of the answers about the difficulty changing culture: *“Legacy employees tend not to like the new leader. [It is] not easy to transform mom and pop businesses to professional, sophisticated corporate environment”*. Several private equity professionals commented about what can be attributed to a management transition risk. The following issues were mentioned: *“Concentration of knowledge and relationships with family members”*, *“need to build a team in the organization - especially in financial arena”*, *“owner starts competitive firm”*. Additional risks concerning family dynamics included: *“Personal issues between family members”*, *“family insider deals”*, *“family members in positions they are unqualified for”*, *“interference of inactive family members”*, *“the family makes decisions based on family politics and not data driven decisions”*. Other risk types mentioned were *“family firms often place their trust in professional advisors that lack experience in these type of transactions”*, *“nobody listening to the PE Fund”*, *“risk of improper transactions with related companies”*, *“to ask them to listen to your advice and counsel is to ask them to go against the very grain of their nature and to ignore their historical*

experience of being rewarded precisely because they do not listen to counsel”, “non-market transactions with suppliers or customers given personal history”.

The next set of questions aimed at revealing how private equity professionals deal with family firm-specific risks. Due diligence for dynamics of relationship and team followed by financial due diligence seem to be the most important risk-mitigating measures undertaken by the private equity investors (mean values 5.69 and 5.29 respectively). The due diligence process was described as one wherein some party has to examine every detail of the operation, structure, ownership, assets or another issues related to a counterparty (De Cleyn & Braet, 2007). Koryak and Smolarski (2008) argued that it pays off to invest in revealing real risk-return profile of a potential investment and management capabilities of the target company to be acquired. High perceived riskiness of family firms is associated with greater reliance on different types of due diligence. In fact, the higher the perceived risk, the more checks are necessary. On the other hand, the question whether family firms earn a higher internal rate of return (IRR) is negatively correlated with all the due diligence types (correlation coefficient around -0.2 for all the three types of due diligence significant at the 0.05 level). This is somewhat contradictory: investments with a higher IRR usually bear a higher risk. Apparently, if private equity investors perceive that an investment has a potential to have a higher IRR they are more optimistic and invest less time in pre-acquisition controls.

Among the three contractual procedures, earn-out provision seems to be the least important when dealing with family firms (mean = 4.64), although there is rather an agreement than disagreement that there is more need for this contractual provision in acquisitions involving family firms. This form of an outcome-based contract is used to align agent's incentives with the goals of the principals to induce desired action. Koryak and Smolarski (2008) argued that excessive reliance on these contracts may have managers engage in practices detrimental to an

organization. So, probably, it is a common practice in the private equity industry not to rely too heavily on the outcome-based contracts such as earn-outs.

Almost all the risk-mitigating measures are positively and statistically significantly correlated with each other. This can be interpreted in the following way: private equity professionals who tend to think some measure is more important in family firm transactions generally tend to think so about several of the measures. All the three types of due diligence are correlated. This means that more of any type of due diligence means more due diligence in general. The connection is the strongest between financial and legal due diligence (.839**), while the other two correlation coefficients are around 0.4 significant at the 0.01 level.

Open-ended question allowed respondents to list any additional risk-mitigating measures and explain reasons for them to be introduced. One of the crucial measures mentioned was a non-compete agreement. Indeed, the risk that previous owner starts a competing firm was mentioned in additional risk types. Certainly, this is a profitable although not a fair strategy for a family firm owner. She or he receives money from an investor, starts another firm and persuades old customers that they become clients of a newly-established entity. This can sometimes be the case, because *“often family owners have no other career skills”*. In addition to a non-compete agreement, a thorough due diligence on relationships and dynamics of the team has to be performed. Special attention should be given to the motives to sell. If a true motive is other than retirement or start of a new venture in a different field, a private equity company needs to become alerted. One of the private equity professionals commented: *“If one member is leaving and another is staying, get to the bottom of it”*. Earn-out provision, as well as seller note were also recognized as necessary measures since the *“link to ongoing success of the business is important and maybe more so than in traditional situations.”* The need to keep *“them invested in future success of business”* is motivated by the fact that *“family managers usually have the customer*

relationships or an instinctive knowledge of the business that must be retained". As mentioned above, transition risks were found to be the most important ones when dealing with a family firm target. This finding was mirrored in the following comment: *"Transition plans must be iron clad and crystal clear and preferably written down if not contracted. All parties must agree on how a transition will occur - multiple times over"*. Another private equity professional mentioned the need to discuss a *"limited period for post-transaction employment of family members"* in order to have *"the flexibility to upgrade management"*.

Higher riskiness of family firm investments is negatively correlated with the valuation.

<<Insert Graph 2 about here>>

This means that private equity professionals perceiving family firms as riskier targets look to mitigate for this with the price. A linear regression of valuation item on the higher riskiness item, confirmed this hypothesis. Indeed, slope coefficient is negative and statistically significant. Adjusting for higher risk can also be handled with various risk-mitigating measures discussed above. In addition, one of the respondents mentioned that the discount can also be in terms of structure. The private equity professional mentioned that he or she would always want the family to own a stake in the business junior to his or her securities.

An open question regarding reasons for a discount or premium revealed several interesting issues. Private equity professionals named the following reasons for a family firm discount: *"Need to professionalize management team and organizational structure"*; *"management gap / lack of transition plan with family firm"*, *"difficult to replace founder / family member"*, *"higher probability of losing customers and employees"* *"great concern about the integrity of the seller and the associated risk of undisclosed liabilities"*; *"poor internal financial and information controls"*, *"more uncertainty regarding smooth transition"*, *"lack of professional systems, transparency, comfort of transition"*, *"longer expected time to closing and*

higher uncertainty seller would actually sell". These answers indicate that the main reasons for a discount are the need to replace management and the lack of infrastructure. Indeed, a respondent's comment supports the latter: *"Any discount is mainly due to the lack of infrastructure in the company which is why I would argue family firms typically trade at a discount. That's not to say it is because it is a family firm, but because most of the family firms I have seen or acquired have lacked institutional infrastructure such as proper accounting systems, etc."* Some respondents admitted that they could negotiate a discount due to *"less competition to acquire the target"* or the fact that often family firms are *"not as sophisticated in negotiations"* and *"will accept a discount in order to avoid an auction process"*. It should be noted that three private equity professionals listed reasons to pay a premium for a family business. Two answers were connected to a higher upside potential, while the third attributed a higher valuation due to the fact that *"younger generation taking over was well positioned to grow the business"*. It can be argued however that the realization of the upside potential is a merit of private equity professionals and has its costs. Consequently, it is questionable if acquirers should pay a premium for such a target. Below, the topic of family firms' upside potential is discussed further.

The question regarding post-buyout actions was aimed at indicating if our proposition about family firms' upside potential from the chapter 2 made sense. There we argued that the shortcomings of family firms may be overcome through active management by the private equity investors and represented an untapped potential. I matched weaknesses of family firms from our exploratory research with actions aimed at improving them. The results of the survey suggest that our proposition may be true. The level of agreement was really high: all the actions had a mean above 4.7. Interestingly, the main reasons for discount, the need to replace management and the lack of infrastructure, coincided with the most popular post-buyout measures. "Improve the use of management information systems (MIS)" and "Enhance management team with more

competent members” have mean values of 6.18 and 6.15 correspondingly. This may be taken as a hint that family firms in fact offer some upside potential. However, before making a definite statement, a more profound research is necessary.

Private equity professionals who perceive family firms as higher risk investments are also those for whom the investment period is longer (0.173*).

<<Insert Graph 3 about here>>

Family firm is an entity that comprises both family and business matters. Consequently, with twice as many issues to be analyzed due to higher riskiness the sale process takes longer. Indeed, the increased length is also connected to the additional due diligence to be performed. In fact, financial and legal due diligence are positively correlated to the length of the acquisition process (0.303** and 0.264** respectively). Previous academic studies noted that transfer of the family firm to the next generation is a lengthy process that may take up to 15 to 20 years (Dyck, Mauws, Starke, & Mischke, 2002; Handler, 1989; Sharma, Chrisman, & Chua, 2003; Vancil, 1987; Ward, 1990). These findings may suggest that also another type of succession, the family firm sale, may take somewhat more time than an acquisition of a non-family target.

Familiarity with family firms is not correlated with perception of family firms as riskier targets, neither is it correlated with any of risk types. A possible interpretation is that family firms are generally perceived as riskier targets and this perception is not dependent on the amount of experience of private equity professionals with this type of firms. This finding is further discussed in the Implication for Practice section.

Cluster Analysis

Cluster analysis was meant to reveal whether there are any broad types of private equity professionals, with common attitude towards family firm targets. A two cluster solution was adopted. The first cluster includes private equity professionals who perceive family business risks

to be higher and consequently see more need in risk-reducing measures and assign lower valuation to family businesses. They are also the ones who are undecided whether family firms are turnaround situations versus the second group who somewhat disagrees with this statement. Process length and familiarity with family firms are the same for both clusters.

Another cluster analysis involved examination of the measures that private equity professionals undertake post-acquisition. Private equity professionals that invest more effort in their targets are those who are inclined to think that family firms are more likely to be turnaround investments. Indeed, a turnaround investment involves more work from the acquirer's side as compared to a regular buyout. Familiarity, length of the acquisition process and valuation are the same for both clusters.

Factor Analysis

In order to explore whether there was a more general pattern underlying the responses of private equity professionals, the data was factor analyzed. Extraction was based on the Eigenvalue-greater-than-one rule (Kim & Mueller, 1978). Factors with Eigenvalues greater than one are considered significant, explaining an important amount of the variability in the data, while Eigenvalues less than one are considered too weak, not explaining a significant portion of the data variability. In addition to the Eigenvalue-greater-than-one rule, the scree test was employed to double-check the number of factors (Tucker, Koopman, & Linn, 1969). On the scree plot, the "elbow", i.e. the point at which the curve bends, is considered to indicate the maximum number of factors to extract.

Analysis of risk types resulted in a two-factor solution (62.4% of the total variance explained). It revealed that the risk that owners back out of transaction stands out from other types. Factor one incorporates all but this risk type, while factor two contains only the risk that owners back out of transaction. This risk type can be hardly mitigated with any of the measures

that were included in the survey. In addition, it relates more than others to transaction itself rather than to target characteristics.

Examination of risk-mitigating measures also resulted in a two-factor solution (62.1% of the total variance explained). Factor one is associated with a concern of preventing negative issues that can be identified through different kinds of due diligence pre-buyout or mitigated with an escrow account post-buyout. Factor two relates to stimulating collaboration from sellers' side. Through an earn-out and a minority stake sellers should become interested that a company performs well post-buyout.

CONCLUSIONS

Contributions

Families represent a unique group of active owners that hold concentrated position in their firms for a long time. Throughout their ownership they create a set of distinctive resources, company's value systems and organizational structures specific to family firms. Most of family firms do not manage to pass the ownership to the next generation and often sell their company to a third party. This paper unveiled perception of family firm targets by an important class of acquirers, private equity firms.

This paper improves the understanding of family firms in several ways. Perhaps the most important finding from this study is that family firm targets are indeed perceived to be riskier by their acquirers and that this can have negative influence on the valuation. In addition, higher perceived risk was connected with a more intensive usage of risk-mitigating measures, and a different structuring of the deal (junior versus senior securities) was suggested. Consequently, the perception of risk, even though it may be different from the actual levels of risk, influences investors' behavior. Second, evidence is provided that the two most important family firm

targets' risks are connected to management and culture transition. Next, this study suggests that almost all the risk-reducing measures are correlated. A possible interpretation is that private equity professionals who think one of the measures is more relevant for family firms than for their non-family counterparts tend to think so about several measures.

Limitations and Suggestions for Future Research

This paper presented several interesting findings. However, several limitations should be noted. The use of cross-sectional data does not allow any causality inferences. Furthermore, being a continuation of a study of Western-European investors and distributed among the US-American private equity firms, this research is limited to the developed economies. Findings from the emerging economies may differ significantly. A longitudinal study involving both developed and emerging economies would definitely be of interest. Furthermore, this paper intended to make a statement about how actors interpret reality rather than the reality itself. Consequently, a different research methodology may be employed to study the relation between perceived and actual levels of riskiness of family firm targets.

Implications for Research

This is one of the first empirical studies of family firms as acquisition targets that analyzed perceptions of private equity professionals. The paper makes several contributions to research on family firms. First, it develops the topic mostly overlooked by the family business scholars. While succession was traditionally the most prominent and frequently discussed theme, alternative succession routes, such as sale, was almost completely ignored. Second, the results suggest that major source of lower valuation of family firms is a higher riskiness. A detailed study of the sources of family firm specific risks could advance our understanding of the

influence of family ownership on firm value. Third, the study highlights the necessity to better understand risk-mitigating measures and their relations to different types of risks.

Findings also have implications for the private equity literature. Most empirical research on private equity is in the area of venture capital or public-to-private transactions. This paper extends it into the under-represented, yet practically and theoretically important, sphere of buyout firms. In addition, it was aimed to contribute to an under-studied area of how private equity investors' perception of the riskiness of potential investee companies influences their valuation and investment process.

Implications for Practice

Family firms that have a business divestiture on their horizon should implement measures aimed at reassuring potential acquirers in a smooth transition to a new ownership. Previous research on transfer of the ownership within the family suggested that succession planning improved the satisfaction with the succession process of both incumbents and successors (Sharma et al., 2003). In addition, planning contributes to success of the succession itself (Smyrnios, Romano, & Dana, 2000). Given the findings from the current study and drawing parallels from the previous research on the intergenerational family firm transfer, I suggest that a family foreseeing a sale of its firm should start planning ahead of time. By doing so, transition to a new owner can be made smoother, risks reduced and potentially higher valuation may be realized.

On the other hand, acquirers need to be aware that family firms form a particular class of acquisition targets and act accordingly. Not a single survey participant indicated that she or he had no experience with family firms, so familiarity ranged from slightly to extremely familiar. Indeed, some of the private equity professionals refused to participate, because they had too little or no experience with this type of targets. Accordingly, this study may help professionals who deal with family firm targets for the first time to learn from their more experienced peers.

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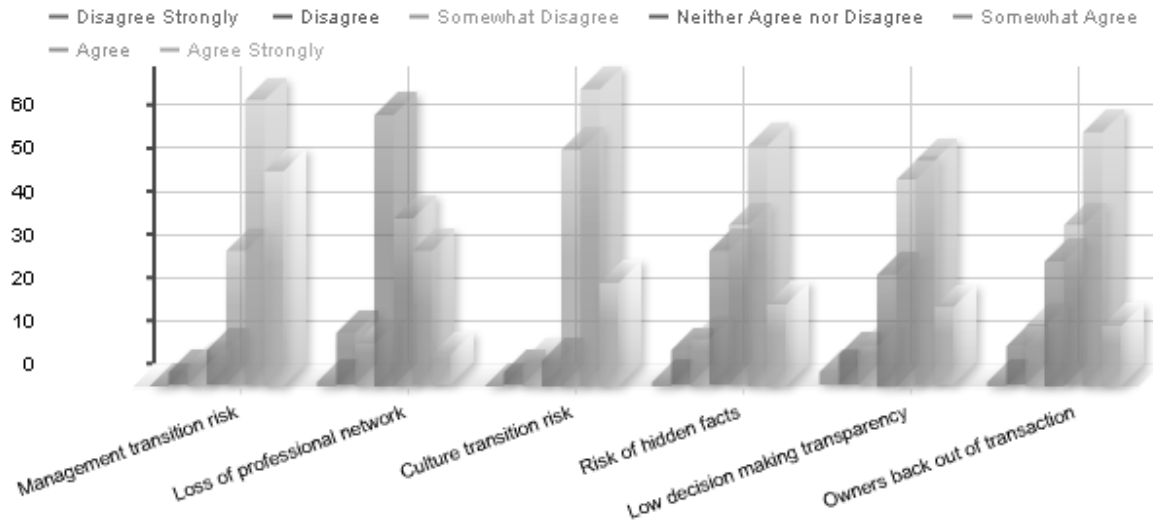
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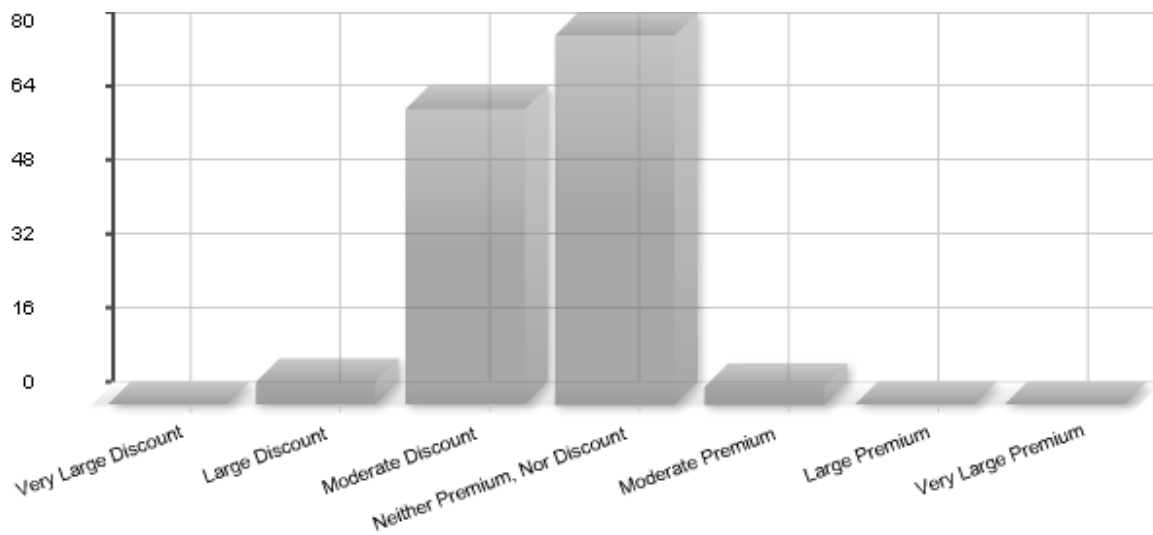
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GRAPHS

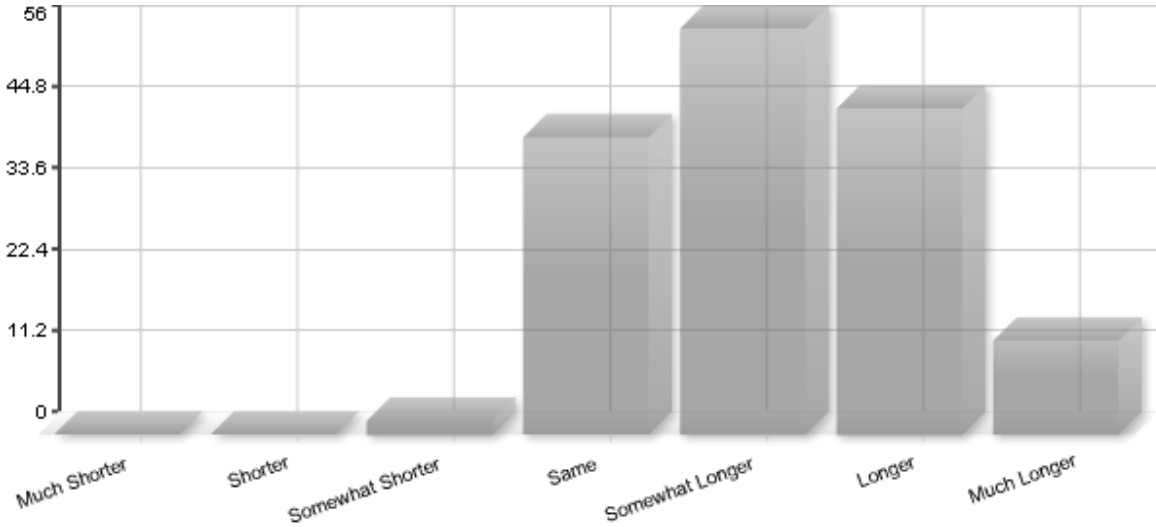
Graph 1. Risk Types in the Family Firm Acquisition



Graph 2. Family Firm Valuation in the Acquisition Context



Graph 3. Process Length of the Family Firm Acquisition



APPENDIX

Questionnaire

Do you agree with the following statements?

	Disagree Strongly	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Agree Strongly
Family firms are higher risk investments	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Family firms earn a higher internal rate of return (IRR)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

The following risks are **HIGHER** when you deal with family firm targets as compared to non-family firm targets:

	Disagree Strongly	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Agree Strongly
Management transition risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Loss of professional network	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Culture transition risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Risk of hidden facts	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Low decision making transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Owners back out of transaction	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please specify the most important risk connected to investment in family firms.

- Management transition risk
- Loss of professional network
- Culture transition risk
- Risk of hidden facts
- Low decision making transparency
- Owners back out of transaction
- None of them

Please list any additional risks connected to investments in family firms.

In acquisitions involving family firms, there is more need...

	Disagree Strongly	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Agree Strongly
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In acquisitions involving family firms, there is more need...

	Disagree Strongly	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Agree Strongly
...to include an earn-out provision	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
...to leave a minority stake with current owners	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
...to have an escrow account	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
...for additional financial due diligence	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
...for additional legal due diligence	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
...for additional due diligence on the dynamics of the relationships / team	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please list any additional deal clauses or process particularities of investments in family firms.

Why are these contracting details needed?

What is the length of an average investment process in family firms as compared to non-family firms?

Much Shorter	Shorter	Somewhat Shorter	Same	Somewhat Longer	Longer	Much Longer
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Imagine two privately-held companies equal in every respect except one is a family firm and the other is not. How would you value a family firm target as compared to a non-family firm target?

Very Large Discount	Large Discount	Moderate Discount	Neither Premium, Nor Discount	Moderate Premium	Large Premium	Very Large Premium
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Recall the last transaction when you have assigned a discount or a premium to a family firm. What was the reason?

As a private equity investor, you achieve the following with the companies you acquire:

	Disagree Strongly	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Agree Strongly
Increase business' transparency	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Improve the use of management information systems	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Improve organizational structures	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Make firm more financially efficient (e.g. drive up margins, cost cutting)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Increase growth rates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Enhance management team with more competent members	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Distribute job functions more evenly among management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

As a private equity investor, you achieve the following with the companies you acquire:

	Disagree Strongly	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Agree Strongly
Specify contractual restrictions on the behavior of remaining managers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Family firm transactions are MORE LIKELY to be turnaround situations than investments in non-family firms.

Disagree Strongly	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Agree Strongly
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

How familiar are you with family firms (includes your experience throughout your career)?

Not at All Familiar	Slightly Familiar	Moderately Familiar	Very Familiar	Extremely Familiar
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>