CHAPTER 4.

Succession Planning in Polish Family Businesses. An Exploratory Investigation

Aleksander Surdej and Krzysztof Wach

4.1. Introduction

Family firms have become a topic of the utmost interest both for academic researchers and policy makers. Researchers have started to investigate the distinctiveness of family firms, their functioning and efficiency outcomes. Policy makers have been reacting to the problems of economic development arising from the domination of family owned and family controlled firms in many economies.

Most of the research projects on the succession process in family firms has been conducted in Western countries and there is a lack of understanding of the succession process and its determinants in family firms in Central and Eastern Europe, that is why we decided to conduct the research survey in Poland[1], which seems to be a pioneering project as far as the country – Poland – is concerned[2].

The research sample includes 496 family enterprises, among them 85, which accomplished the succession process and 147 family firms, which are going to face the succession issue. The paper includes research results of the

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[1] Research project "Succession Scenarios in First Generation of Polish Entrepreneurs" conducted in the years 2008–2010 by Aleksander Surdej and Krzysztof Wach was financed by Polish Ministry of Science and Higher Education (Project no. 1326/B/H03/2008/34).

[2] Currently a large research project is run by the market research firm PENTOR, contracted and funded by Polish Agency for Enterprise Development (PARP).

one studied group, that is enterprises planning to implement the succession process[3].

4.2. Literature Review

The succession issue has been identified as one of crucial factors for the functioning and growth of family firms. It is reported, what seems like cross-national regularity, that only 30% of family firms survives in the second generation, while less than 14% functions in third generation as still family firms (Fleming, 1997, p. 246; Matthews, Moore, Fialko, 1999, p. 159).

From the theoretical point of view the succession in family firms is related with the dilemma how to preserve (and possibly increase) family wealth, while transforming the company. Is it better to keep family control over the company, but possibly harm its growth perspectives, or rather to transform it by diminishing the family control (or even eliminate it altogether).

Thus, there might be different types of succession. First type might be called a *defensive succession*, in which family tries to preserve the control over enterprise at all costs. Second type might be called a *transformatory succession,* in which the company is transformed so as to maximize the wealth of family even at the cost of reducing the family control.

It seems that the first type of the succession dominates among SMEs (Micro-, Small and Medium-Sized Enterprises) as they operate undiversified business and the firm's success depends very much on the use of idiosyncratic knowledge – tacit and informal knowledge which has been acquired over long time and their use is of limited application elsewhere. This might explain why small firms try to find the successor among family members, relatives or close friends. This explains also why a career path in such small firms is of limited value to outsiders. The conjunction of these two factors creates the peculiarity of succession in small family firms[4]. Holmstrom and Milgrom have suggested that this type of family firm can be analyzed as a "multi-target unit" (Holmstrom, Milgrom, 1991), whose members contribute to the generation of income and profits, but at the same time they are a community of organizational and entrepreneurial knowledge, and not the least, of emo-

[3] For research results on accomplished succession processes among Polish family businesses see (Surdej and Wach, 2009).

[4] Using the criteria differentiating family firms we see that these firms are characterized by strong overlapping of family ownership, management control and involvement in day to day functioning.

tional support. Thus, in family firms key people are renumerated for all the functions they fulfil.

But, a different succession is needed when a family firm has grown or has been set to grow. A growing firm requires an access to external finance, if external financing comes in the form of equity, a firm governing structure has to change in order to accommodate outside investors. In addition, such a growing family firm has to hire external managers as it has no possibility to fill all posts of responsibility with qualified family members. These remarks support the statement that in a context of a family firm's growth a succession happens most likely before the owner founder reaches the age of retirement or physical incapacity. A growth oriented family firm will reach the threshold of succession as ownership, management and organizational transformation earlier than survival oriented family firms. In such growth oriented family firms succession means the introduction of formal rules that reduce the importance of personal relations and the introduction of accounting procedures which would increase the transparency of firm's financial operations to outside investors. A transformatory succession leads to the implementation of governance standards which would not differentiate family controlled companies from other publicly quoted companies. More, family controlled companies, may as it is shown by research of Ashiq Ali, Tai-Yuan Chen and Suresh Radhakrishnan (2007) on a sample of family controlled companies quoted at NYSE, perform better than non-family controlled companies in terms of the quality of financial reports, voluntary disclosure of negative information and voluntary information about internal corporate practices.

Contemporary academic literature converges in a conclusion that businesses often begin by taking advantage of small (relatively) networks support,[5] and that network relationships play a key role in facilitating exchange in developing economies such as sub-Saharan Africa and that „These relationship differ from pure market exchange in that they perform economic functions other than trade itself, such as information sharing, informal enforcement of contracts, and interlinking" (Fafchamps, 2004, p. 294). But, the exclusive reliance on informal networks limits the efficiency of market exchange and business growth. If an institutional environment does not pro-

[5] A study of over 14,000 Mexican small enterprises shows that owners chiefly used their own savings (61%) or those of their family and friends (14%) to start their own firms (Hernando–Trillo, Pagan, Paxton, 2005) confirming the relevance of what jokingly became known as "the 3F source – meaning Family, Friends and Fools".

vide formal instruments to substitute for informal ones, the economy suffers from unexploited efficiency gains and growth potential.

Family firms can be analyzed as firms whose foundation and functioning depends on a particular network – family. It is a network whose borders are defined by pre-existing bonds of kinship – that is why it is closed and its enlargement proceeds by births or marriages. Larger similar networks are also traced by pre-existing bonds of tribal or ethnic origins. Larger a network is, there is more gains to be achieved from trade or cooperation, but its expansion might increase the difficulty in triggering joint action (for instance entering exchange, completing transaction). Thus, a factor such as the strenght of family ties might which might be productive to initiate a firm, can prove detrimental to its growth. The quality of institutional environment seems to act as a factor determining the likelihood with which family firms implement growth oriented succession transformation.

There is a growing amount of economic literature devoted to the relationship between institutional factors and economic performance of firms[6] and more generally between institutions and economic development[7].

Scholars point out many factors influencing the succession process. The institutional environment plays an important role in the succession determinants (Surdej, 2009; Wach, 2010). It is stressed that three variable such as the development of capital markets; the minority ownership protection and the legal contracts enforcements, are of special importance in this regard.

The depth and institutional diversity of capital markets broadens the scope of succession methods in growth oriented family firms. Thus, for instance, the existence of venture capital funds allows family firms to get external financing from sources (financial institutions) which monitor them, but do not aspire to management control and it allows to draw on their experience in preparing the company for „going public"[8]. The existance and the size of the stock exchange allows a company to „leverage its capital" and to ac-

[6] See especially the articles in the Journal of Financial Economics (various issues).

[7] For a useful summary of the current stage of discussion see (Tabellini, 2008).

[8] These are not theoretical possibilities, but solutions implemented in such diverse countries like Poland (Zielona Budka – family firm producing ice-creams accepted venture fund financing, reduced its control, went public and withdrew from the public quoted company, but Mr. Grycan – the founder of Zielona Budka, started a new ice-cream producing firm called after his name Grycan, when due period of abstention from competing activities has expired – see: J. Cieński, *The Ice-Cream King of Poland*, in "Financial Times", 22 July 2009.

celerate the development[9]. The data gathered by the World Bank shows that advanced economies are characterizied by a higher level of stock market capitalization, which confirms a hypothesis that in such countries a family firm can be more easily transformed into a public, but family controlled, firm.

The question of the strength of minority ownership protections is directly related to the growth oriented succession. A growing family firm is likely to acquire other (non-family) shareholders. By this family ceases to remain the sole owner, but it might remain the majority shareholder. But to get an external investor the family has to credibly signal among other that it will not get involved in self-dealing and in extracting private benefits of the firm´s control. Unless legal regulations reduce the threat of self-dealing, including the extraction of private profits through the transaction between related companies, external investors not related to the family, will not have trust in investing in them (Djankov, La Porta, Lopez-de-Silanes, Shleifer, 2008). Although Djankow, La Porta, Lopez-de-Silanes and Shleifer seem to link the strength of anti-self dealing regulations with the legal origin (according to them common law countries provide stronger protection than the Continental Europe Law Countries), it seems that in general the level of minority owners protection varies with the level of economic development and that developing economies are characterized by a weaker minority ownership protections regardless of the origin of the inherited law.

The recognition of the importance of formal contract enforcement mechanisms comes from the observation that many economic transactions are not of instant and simultaneous character. A *quid* happens first and there might be uncertainty about *quo*. A promise to deliver *quo* needs to be backed by an enforcement mechanism. Subsequent reports of the World Bank[10] try to measure the quality of enforcing contracts in all countries. The data providing by the World Bank point at a positive correlation between the easiness of enforcing contracts and the level of country's economic development: Developed economies (with notable exception of Latvia) score better in the ranking of contracts enforcement.

[9] Family focused nature of business is perceived as one of *principal obstacles facing the private equity financing,* BUT *Private Equity Financing might be* 'help for family members to evolve beyond founders' [Eid, 2006].

[10] The series "Doing Business" with the most recent report: Doing Business 2009 by the World Bank.

4.3. Methodological Assumptions

The research was conducted within the project "Succession Scenarios in the First Generation of Family Firms in Poland" [11].

The main aim of this empirical research was to identify the succession modes of the first generation of Polish entrepreneurs. In order to investigate the research problem we have conducted the empirical survey and have analysed the collected data in order to identify the dominant succession mode in Polish family firms, and to define the determinants of the choice of a given succession strategy.

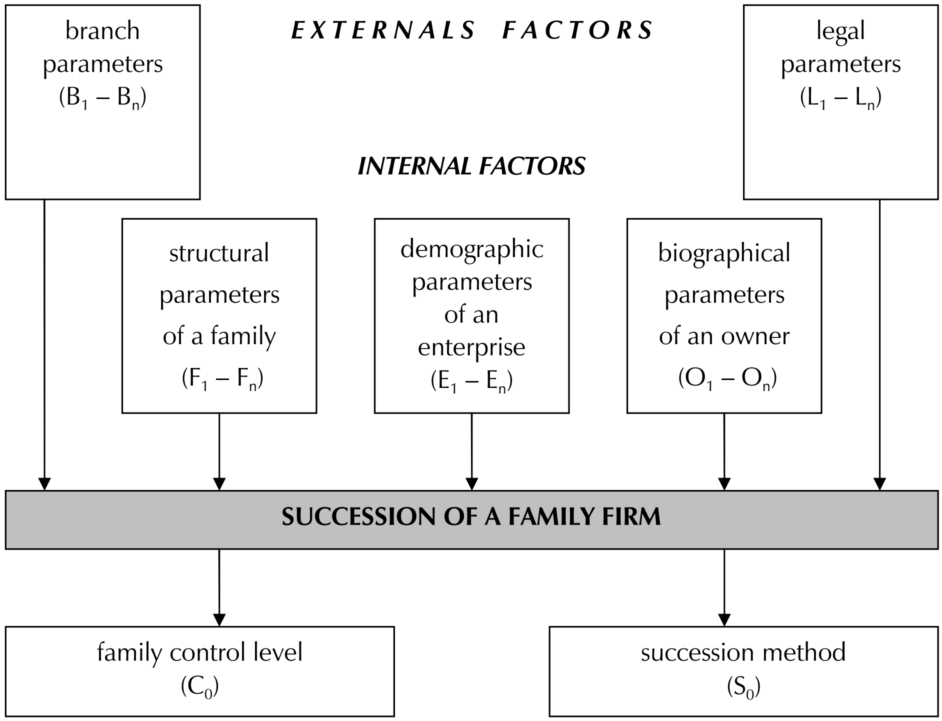

Figure 4.1. Research Model: Determinants of Succession in Family Firms

[11] The research project was conducted at Cracow University of Economics – Faculty of Economics and International Relations in the years 2008–2010. The research project was fully financed by the Ministry of Science and Higher Education of Poland.

Based upon existing literature we have tentatively indicated the following groups of determinants which are likely to influence the choice of succession mode (three internal and two external forces):

- structural parameters of an entrepreneur's family;
- demographic parameters of the company;
- individual entrepreneurial history of an owner/founder;
- parameters of the organizational and legal environment in which a company functions;
- basic parameters of the sector in which a company functions.

It can be supposed that these factors determine the choice of the succession mode and the choice of the preferred control level of family over the company). Figure 4.1 and table 4.1 summarize also the factors that determine the choice of succession methods in general. With reference to the discussion developed so far it should be stressed that the relative weight of factors changes depending on the type of succession. *A defensive succession* depends much on the family's structural parameters and on intra-family relationships (conflicts, emotions). *A transformatory succession* depends on the existence of institutional instruments which help to solve the conflict between the growth orientation of a firm and the founder/owner interests in preserving/increasing family wealth.

Table 4.1. Variables of the Implemented Research Model

Factors	Variables
structural parameters of a family	▪ the size of the family ▪ generation spread ▪ sex of the first child, ▪ relationship within the family
demographic parameters of an enterprise	▪ age ▪ size ▪ scope ▪ the branch of the industry
biographical parameters of an owner	▪ age ▪ sex ▪ level of education ▪ entrepreneurial attitude ▪ history of earlier entrepreneurial activities
branch parameters	▪ innovativeness level within the branch ▪ competitiveness degree within the branch

Factors	Variables
legal parameters	▪ rules of corporate governance ▪ development of capital markets ▪ minority ownership protections ▪ legal contracts enforcement
family control level	▪ family absolute control ▪ family majority control ▪ family minority control
succession method	▪ passing the family business to the heir ▪ selling the whole family business ▪ selling the part of the family business ▪ quoting on the stock exchange

Manager perception was chosen as an operationalization method, thus it assures the acceptable correctness and the reliability, and first of all tops other methods in relation to practical usage, what is more it is applied in analogous research very often (Lyon, Lumpki, Dess, 2000, p. 1055–1085). This method was applied for all qualitative variables. Thus a survey (proceeded with a diagnostic pre-survey) was applied as a main investigative technique, replenished with technique of observation. Each area was verified by asking from 5 to 7 questions. For quantitative variables as operationalization method data analysis was applied. In support of received and accepted variables the questionnaire of inquiry was constructed as a basic investigative tool. Qualitative approach in an inquiry was applied mainly, which is the most often applied approach in analogous investigations. Thus, for evaluation of variables 5-degree Likert scale with qualitative answers was applied.

4.4. Empirical Findings

Research survey was conducted on a random sample of 496 family enterprises in first quarter of 2009 (table 4.2 and figure 4.2). The companies were divided into three groups:

- 85 family firms which were sold or transferred (17.13%),
- 147 family firms which plan to face the choice of succession (29.64%),
- 264 family firms which are not interested in succession planning (53.23%).

While grouping the studied family businesses, the family structure and history of the research sample seems to be quite interesting:

- 376 studied family firms were initiated by a current owner – so called first generation family business (75.80%),
- 76 studied family firms were initiated by a previous owner – so called second generation family business (15.32%),
- 36 studied family firms are multigenerational with long traditions (7.25%), the oldest one was established in 1869.

Table 4.2. Basic Characteristics of the sample firms (N = 496)

Firm Sector:	**Firm age:**
Agriculture 2.22% (11 cases)	0–5 years 17.22% (82 cases)
Manufacturing 13.91% (69 cases)	6–10 years 17.65% (84 cases)
Services and Trade 86.66% (4210 cases)	11 and more years 65.12% (310 cases)
Business Scope of Operation:	**Business Legal Form:**
Local 36.50% (181 cases)	Sole Proprietorship 70.56% (350 cases)
Regional 24.20% (120 cases)	Unlimited partnership 12.30% (61 cases)
Domestic 22.98% (114 cases)	Limited partnership 7.46% (37 cases)
European 9.27% (46 cases)	Limited company 9.07% (45 cases)
International 6.85% (34 cases)	Others 0.6% (3 cases)

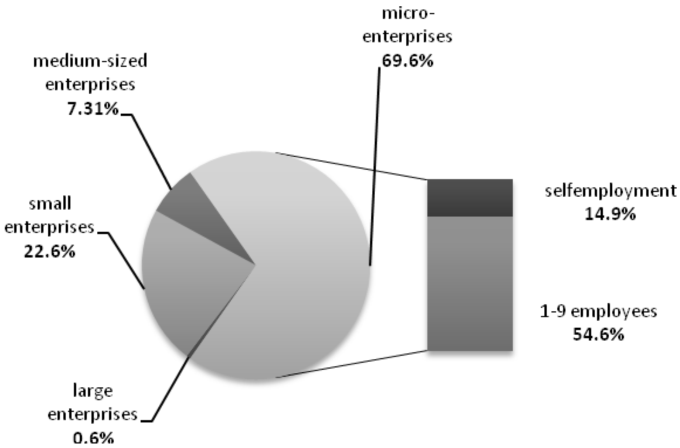

Figure 4.2. Characteristics of the sample firms according to their size (N = 496)

The analyzed group of family enterprises, which plan to carry out the succession in the future, includes 147 units. The sample is interesting as far as the age of the studied family firms are concerned. The youngest firm is 1 and the oldest is 60 years old, but only one fourth of the studies firms are older than 19 (lower quartile Q_1 = 11, upper quartile Q_3 = 19). The arithmetic mean for the age variable is 16, nevertheless the standard deviation is 8, which is quite a wide range. The value separating the higher half of a sample is M_e = 15.

The studied population can be divided into two groups. The first one includes 25% of the research sample. They are the firms that plan to carry out the succession process within a couple of forthcoming years (not longer than in 5 years' time). Three fourth of the research sample have plans concerning the succession of ownership and control, but in longer perspective (more than in 5 years' time).

Majority of the responders declares that the firm will be still a family business, what is more the detailed distributions of answers are as follow:

- 110 cases (74.8%) definitely yes,
- 34 cases (23.1%) rather yes,
- 2 cases (1.4%) not obvious yet,
- 1 case (0.7%) no.

The level of the family control over the family business is quite interesting (table 4.3). Both, at present at after the planning succession, the family absolute or majority share is declared by 119 family firms, however the percentage of firms declaring the family absolute share is much higher at present.

Table 4.3. Level of Family Control Over Family Businesses (N = 147)

Family Control Level	At present	After the planning succession
Family absolute share	112	101
	76.2%	68.7%
Family majority share	7	18
	4.8%	12.2%
Family minority share	26	24
	17.7%	16.3%
No answer	2	4
	1.3%	2.7%

In the studied population there were only three ways of planning succession observed. The most popular way of succession is going to be the passing to the heir (95.9% in 141 cases), other forms of transfer control and ownership were not so popular, among them selling the whole business (1.4% in 2 cases) and selling the part of the business share (1.4% in 2 cases).

The plans for the forthcoming succession will be prepared – according to responders' declaration – in 76 out of 147 cases (51.7%), which is quite a satisfying figure comparing to the accomplished succession research results (Surdej and Wach, 2009), but unfortunately it is still a low figure. The number of issues in the forthcoming succession plan differs from 1 to 6 (1 issue in 33 cases, 2 issues in 29 cases, 3 issues in 4 cases, 4 issues in 8 cases and 6 issues in 2 cases).

Considered elements of the forthcoming succession plan are as follows:

- the identity of the successor in 43 cases (29.25%),
- the preparation of the successor in 38 cases (25.85%),
- the division of shares in 29 cases (19.73%),
- taxation issues in 20 cases (13.60%),
- sale and purchase of shares in 14 cases (9.52%),
- external shareholders in 4 cases (2.72%). .

Only in one fourth of cases the forthcoming successor is going to be a female (versus 72.1% of male). The younger forthcoming successor within the family will be 20 and the oldest will be 52 years old, however only 31.9% of the declared age answers exceed 30 years old, which proves that the second generation of Polish enterprises are going to be extremely actively involved in currently run family businesses (most of them are currently involved in the family firms, both passively and actively). While planning the succession process, the potential successor plays the important role, however almost a one third of the initial founders takes only one criterion into consideration, but two criteria are applied by another one third of responders (three criteria by 27.21% and five criteria only by 1.36% of responders). In the studied firms the following issues are going to be taken into account in the succession planning process:

- family reasons (in 118 out of 147 cases),
- qualifications of the successor (88 cases),
- motivation of the successor (65 cases),
- personal reasons (5 cases)
- other reasons (7 cases).

4.5. Conclusions and Implications

Ownership and control succession in family firms is a topic of both theoretical and empirical interest as it helps to bridge the gap between economics and management sciences. Until recently succession in family firms has been predominantly studied by management scholars, while family firms efficiency properties has been analyzed by economists. Fortunately, more and more scholars try to bridge this divide and, as it has been shown by John Roberts in his influential "Modern Firm" (2004), they apply assumptions, approaches and models which show an ability to develop a uniform approach to studying social and economic phenomena. Succession in family firms is a choice of a model of organization transformation with significant implication for the efficiency of markets and modern economies. Thus, they share a broader theoretical perspective integrating economic and management research.

The analysis of the succession in family firms should be transformed from a rather narrow perspective of identifying, educating and nominating a successor in order to keep the control of the firm in the hands of the family to a problem of analyzing succession choices in growth oriented companies as such a succession requires a deeper transformation of the enterprise organizational structure and corporate practices.

In our study the sample of 496 family firms was surveyed, but only in 85 cases the succession process was found accomplished and in 147 cases the initial founders of family businesses are planning the forthcoming succession. The research results allow to formulate the following tentative conclusions:

- The most popular way of succession in the studied group is the passing to the heir (95.9%).
- After 20 years of economic transformation, founders of new enterprises, who are the first generation of Polish capitalists, have started to initiate the process of the transfer of ownership and/or control over their enterprises. One fourth of the studies firms accomplished the succession not earlier than 2 years ago, and the half not earlier than 6 years ago.

The research conducted by us has been inspired by theoretical questions. But due to the lack of reliable data we could test theoretical hypotheses in the context of transitional economy. Instead we have described the important economic phenomenon and have formulated several exploratory hypothesis which would guide our future research.

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