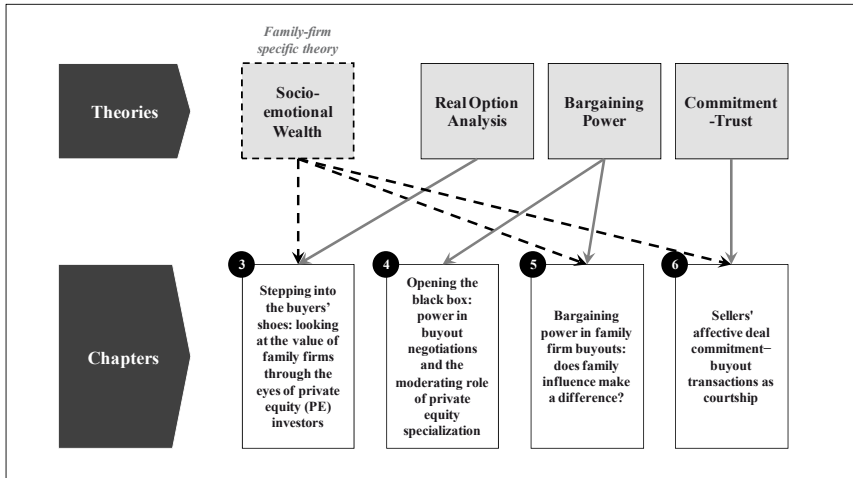


## 2 Research approach

In this chapter, it is explained how the research questions outlined in chapter 1 are addressed theoretically and methodologically in this thesis. Firstly, the theories applied in the subsequent chapters 3–6 are summarized (the theoretical framework). Secondly, the sample used for the quantitative empirical chapters 4, 5, and 6 as well as the data collection process is described. Lastly, statistical techniques to investigate the generated hypotheses are outlined.

### 2.1 Theoretical framework

The subsequent chapters 3–6 employ different theories. Real option analysis is used in chapter 3, bargaining power theory is used in chapters 4 and 5, and commitment-trust theory is used in chapter 6. These theories are complemented by socioemotional wealth theory (SEW) used in chapters 3, 5 and 6. SEW is a "homegrown" theory of family business researchers (Gómez-Mejía, Cruz, Berrone et al., 2011a) and complements the aforementioned theories to facilitate insights particularly related to family firms. Overall, it can be said that this thesis is theoretically "grounded" in SEW theory. An overview of what theories are used in which chapter is given in *Figure 6*.



**Figure 2-6: Theories and corresponding chapters**

Source: Author

### 2.1.1 Socioemotional wealth

Socioemotional wealth (SEW) theory represents the theoretical reference point for the explanation of family-firm-specific behavior throughout this thesis. SEW theory is essentially about the importance of non-economic goals for family firms (Berrone et al., 2012). According to SEW theory, family firms try to realize high levels of SEW so that SEW becomes a reference point for family firms' decision-making (Berrone et al., 2010; Berrone et al., 2012; Gómez-Mejía et al., 2007; Gómez-Mejía et al., 2010; Zellweger et al., 2011). Consequently, decisions in the family firm are often implicitly judged by their contribution to SEW endowment (Berrone et al., 2012), which is not always in the interest of the firms' stakeholders or does not contribute to the financial performance of the family business (Kellermanns, Eddleston, & Zellweger, 2012; Gómez-Mejía et al., 2007). SEW includes a number of affectively motivated needs such as the need for family affiliation and family harmony, preservation and continuation of family values, family control over the family business and the intention to build a family dynasty, the need for trust and family reputation

as well as the preservation of social capital, among others (Gómez-Mejía et al., 2010; Gómez-Mejía et al., 2007; Gómez-Mejía, Nuñez-Nickel, & Gutierrez, 2001; Berrone et al., 2010). The specific importance of SEW for family firms' actions is dependent on forms and the degree of family influence (Berrone et al., 2012). Family influence comprises multiple sources such as ownership, participation in management functions, generations involved in the business, and/or age of the business, among others (Chua et al., 2012; Astrachan et al., 2002; Klein et al., 2005; Ling & Kellermanns, 2010; Dehlen et al., 2012).

SEW can become a dominant motive for family firm sellers in buyouts. In general, family firm ownership is often associated with strong emotional attachment so that the value of the business is, "in the eye of the owner", biased by emotions (Zellweger & Astrachan, 2008; Zellweger et al., 2011; Astrachan & Jaskiewicz, 2008). Through the identification of the family (members) with the business, the family firm becomes a defining component of the family (Zellweger & Astrachan, 2008; Dyer & Whetten, 2006). Moreover, the family firm represents prestige, recognition, and reputation for the family (Chrisman, Chua, & Litz, 2004; Westhead, Cowling, & Howorth, 2001; Berrone et al., 2010), and families will try to secure control over the business (Zellweger et al., 2011). Consequently, the buyout might be accompanied by feelings of regret, as in the sale the family loses control over the business as the generating mechanism of SEW (Shepherd, 2009; Pellegrin, 1999; Niedermeyer et al., 2010).

### **2.1.2 Real options analysis**

Real options analysis (ROA) is concerned with the value of flexibility in investment decision-making. The foundations of ROA were laid by financial options theory (Myers, 1977; Trigeorgis, 1996). The difference between financial and real options is that financial options are created for financial transactions and real options involve "real" assets (Black & Scholes, 1973; Trigeorgis, 1995). In general, ROA is mainly concerned with the value of flexibility in

managerial decision-making under conditions characterized by uncertainty (Pindyck, 1988; Dixit & Pindyck, 1994; Trigeorgis, 1995). As such, ROA can be used to evaluate the favourability of investments (Wang & Lim, 2008; Howell, 2001), to support company valuation (Myers, 1977), and to improve strategic decision-making (Bowman & Hurry, 1993; Bowman & Ambrosini, 2007). It is assumed in ROA that investments and/or decisions have follow-up opportunities and outcomes can be estimated with probabilities (Leiblein, 2003).

The functioning of real options is analogous to financial options. A *financial* call option generates ex post returns when the stock price exceeds the predetermined exercise price, and a put option generates returns when the stock price falls below the exercise price (Trigeorgis, 1996; Hull, 2009). A *real* option can be defined as the “*right, but not the obligation, to take an action in the future*” (Amram & Kulatilaka, 1999; p. 5). Consequently, a financial option's stock price turns into the real option's net present value (NPV) of the potential investment; volatility is the risk of future cash flows, and the exercise price is the cost needed for the follow-on investment (Howell, 2001). The underlying asset is the potential investment, and the option holder's right is given by the opportunity to invest (call option) or to divest (put option) (Howell, 2001).

ROA is applied in chapter 3 for the valuation of family firm in buyouts. Options can be viewed as an important part of firms' valuation, complementing the discounted cash flow (DCF) value (static component) with the value derived from future flexibility or real options (dynamic component) (Myers, 1977; Trigeorgis, 1995). In particular, situations of uncertainty and irreversibility are viewed as essential for applying ROA (Adner & Levinthal, 2004; McGrath, Ferrier, & Mendelow, 2004). Family firm buyouts are considered being high-risk transactions affected by information asymmetries and strong investment irreversibility once a firm is acquired. Thus, ROA is highly suited for application in family firm buyouts.

### 2.1.3 Bargaining power

Negotiations occur all the time, not only in the world of business, and can be defined as “... *the deliberate interaction of two or more complex social units which are attempting to define or redefine the terms of their interdependence*” (Walton & McKersie, 1965, p. 35). "Power" in negotiations is usually referred to as "bargaining power" and is defined as the potential to influence others for obtaining desired outcomes (Kelley & Thibaut, 1978; Bacharach & Lawler, 1981; Dreu & van Kleef, 2004; Kim et al., 2005). Power is subject to individuals' perception, interpretation, assessments, preferences, experiences, values and how available information is processed (Cyert & March, 1963; Bacharach & Lawler, 1976; Leap & Grigsby, 1986; Wolfe & McGinn, 2005; Poppo, Zhou, & Ryu, 2008).

Dependency theories conceive the nature of bargaining power as being related to the dependency of negotiators. The relational aspect of power was emphasized in power-dependence theory, which postulates that A's negotiation power increases when B's dependence on the negotiation relationship grows (Emerson, 1962; Blau, 1964; Wolfe & McGinn, 2005). Thus, a negotiation party provided with a broader set of alternatives can engage in alternatives to the current negotiation relationship and will be less willing to make concessions (Fisher, 1981). Previous research uses the term "context-based bargaining power" to refer to dependency derived from availability of alternatives (Yan & Gray, 2001b). "Resource-based bargaining power" is a derivative of power-dependence theory and assumes that power in relationships originates in the possession of critical resources potentially valuable in the negotiation relationship (Pfeffer & Nowak, 1976; Aldrich, 1977; Pfeffer & Salancik, 1978; Yan & Gray, 2001b).

Power base theories do not directly link to the dependency aspect of the parties involved and rather analyze power from an individual actor's point of view (French & Raven, 1959; Patchen, 1974; Bacharach & Lawler, 1980; Kim et al., 2005). French & Raven (1959) gained prominence with their typology of power bases, such as reward, coercion, expertise,

legitimacy and referent power. The overall efficacy of power (sources) largely depends on the individual negotiation situation and hence no universally applicable framework for negotiation power has yet been developed (Astley & Sachdeva, 1984; Leap & Grigsby, 1986). However, both power-dependence theory and power base theory emphasize that power can only be established in a relationship and thus power is viewed as a relational concept (Yan & Gray, 2001b; Dreu & van Kleef, 2004).

#### **2.1.4 Commitment-trust theory**

Prior research developed a range of different commitment definitions and established levels at which commitment exists such as between individuals, between individuals and organizations or between organizations (Becker, 1960; Anderson & Weitz, 1992; Beamish & Banks, 1987; Cullen, Johnson, & Sakano, 1995). This thesis follows the definition of Meyer & Herscovitch (2001, p. 301) of commitment as a "*force that binds an individual to a course of action that is of relevance to a particular target*". Commitment is driven by similar values, goals, and attachments that lead to relationship continuation (Mäkelä & Maula, 2006; Beamish, 1984; Mowday, Porter, & Steers, 1982).

Prior research acknowledged the importance of commitment for business relationships (Dwyer, Schurr, & Oh, 1987; Lund, 1985; Scheer & Stern, 1992). Commitment has been associated with—along with other effects—higher tendencies of cooperation and desires of relationship partners to achieve mutual profitability, loyalty, as well as long-term relationship stability (Gundlach, Achrol, & Mentzer, 1995; Anderson & Weitz, 1992; Gounaris, 2005) despite relationship alternatives being available (Anderson & Weitz, 1992; Morgan & Hunt, 1994; Ghemawat, 1991). Thus, if an individual or organization is provided with commitment, it is likely to benefit from that commitment.

Different forms of commitment can be distinguished. Commitment is usually differentiated based on the underlying motivation into an "affective" and a "calculative" form (Becker, 1960; Mowday, Steers, & Porter, 1979; Mathieu & Zajac, 1990). While the former form is reckoned to be emotional, the latter is motivated by economic advantages and rationality (Allen & Meyer, 1990; Bansal, Irving, & Taylor, 2004; Fullerton, 2003). It is important for this thesis to differentiate between affective and calculative commitment so that antecedents can be distinguished effectively (Geyskens, Steenkamp, & Kumar, 1998).

## **2.2 Data collection and sample description**

Data collection focused on the buying side of management buyouts. In order to test the hypotheses in chapters 4, 5, and 6, cross-sectional data was collected using a key informant approach (Kumar et al., 1993). Two main categories of respondents were identified as appropriate sources for the research questions outlined in the previous chapter—the buying and the selling side. For a number of reasons, it was decided to contact only the buying side, i.e. PE firm investment managers. Firstly, it is highly difficult to identify a substantial number of family sellers having been involved in management buyouts due to confidentiality reasons and because family buyouts usually take place in less information-efficient private takeover markets (Capron & Shen, 2007). Secondly, it was relatively easy to identify PE firms and managers because industry associations and company websites disclose much of the needed information (EVCA, 2011). Thirdly, PE investment managers were considered particularly suitable because they regularly engage in buyouts and usually deal with both family and non-family buyout targets. Thus, PE managers are well suited to identify and assess differences between family firm and non-family firm buyouts.

Two steps were taken to generate an appropriate target population of PE firms for sampling. Firstly, PE firms appropriate for serving as potential respondents were identified. In

doing so, 856 European PE firms were identified based on membership directories of PE associations and internet search. Elimination of 348 PE firms was necessary, as some PE firms focused on early stage investments, were fund-of-funds<sup>17</sup> PE investors, were mezzanine capital providers<sup>18</sup>, had no deal record, or stopped doing business. 508 individual PE firms remained as suitable targets for the survey.

Secondly, individual investment managers for each PE firm were researched and contacted via email. Individual contact details are beneficial for surveys because personalized surveys are usually more successful than anonymous surveys and lead to higher "quality" of responses (Heerwegh, Vanhove, Matthijs et al., 2005). The electronic survey procedure was chosen because it usually outperforms paper-based mailings in terms of costs, response rates, and response speed (Sheehan, 2001). The survey also contained a short introduction and assurance of confidentiality and anonymity. Respondents' answers to the questionnaire were qualified by using three conditions for participation. Firstly, respondents had to relate their answers to a randomly selected buyout in which their PE firm represented the buying coalition. Secondly, respondents had to be actively involved in the negotiation process. Thirdly, the buyout deal had to have occurred during the last three years.

A high response rate was achieved. 188 PE investment professionals from different PE firms filled-in and returned the electronic survey. Thus, the response rate amounts to ~37 %. Most respondents hold positions as partner or managing director (42%), investment director (43%), investment associate (10%); some provided no information on position (5%). The majority of respondents are from Germany (~27%), Italy (~14%), France (~10%), UK (9%), and Spain (~6%) with manufacturing being the dominant industry of buyout deals in the sample. The transaction value shows a mean of ~ € 224 million. The mean of employees

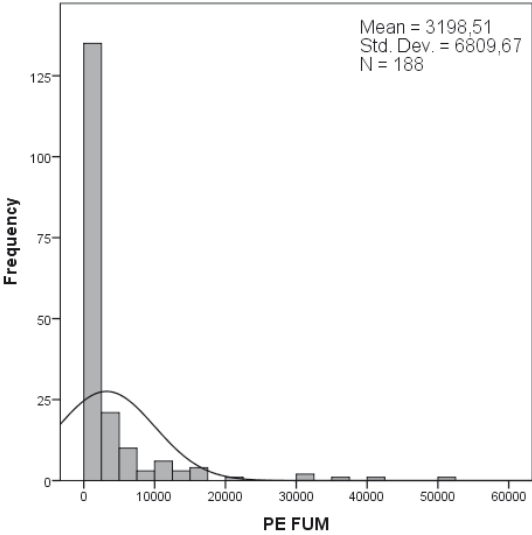
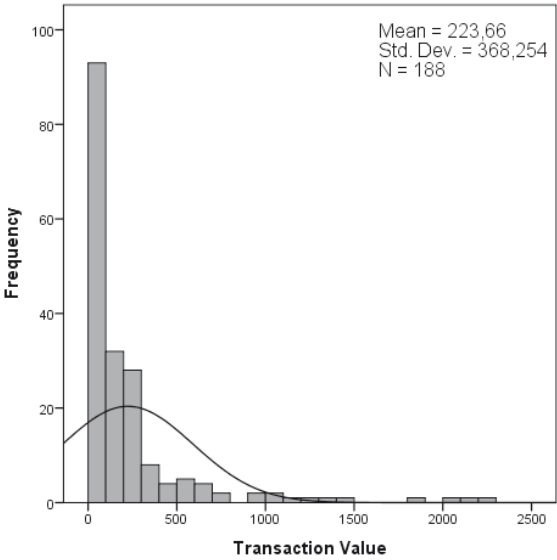
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<sup>17</sup> Fund-of-fund PE firms invest in other PE funds usually without investing into portfolio firms directly (Brophy & Guthner, 1988).

<sup>18</sup> Mezzanine capital is a form of financing usually for SMEs. Financially speaking, mezzanine debt is "senior" to the original equity of the firm, but "junior" to bank debt (Bean, 2008).



involved in reported buyout targets is ~1159 and the mean of sales is ~ € 192 million. The average PE firms' fund under management (FUM) is ~ € 3199 million. A more detailed description of the sample is given in *Figures 7, 8, 9, and 10*. In *Figure 7* it can be easily observed that variables are skewed which requires consideration and countermeasures in statistical analysis. Also, it is necessary to acknowledge that the sample sizes and characteristics in chapters 4, 5, and 6 could (slightly) deviate because respective outliers were eliminated and a family firm subsample was created accordingly for chapter 5.



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