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The Impact of Continuity Outlook and Development Activities on Growth Intentions

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The Impact of Continuity Outlook and Development Activities on Growth Intentions

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Abstract

Despite extensive research into succession planning, little is known about the impact of the continuity outlook of a firm on growth intentions. The objectives of the study are to examine 1) the effect of different continuity outlooks of the firm on growth intentions, 2) the effect of exploration and exploitation activities on growth intentions, and 3) the differences in exploration and exploitation activities between different continuity outlooks of the firm. The data set of 929 responses was collected from CEOs of Finnish SMEs aged 55 or more using a web-based survey. The results show that the most important variable explaining high growth intentions is exploration activity. Succession, co-owners continuing the firm and selling the firm outside the family as continuity outlooks are positively associated with growth intentions in contrast to closing down the firm. Results also show that exploration activities are on a higher level with co-owners continuing the firm or succession as continuity outlooks compared to closing down the firm or selling the firm outside the family.

Keywords: *Business transfer, exploration/exploitation, firm growth, SME, succession*

Track: *Management*

Word count*: 5.187*

1. Introduction

Aging is a great challenge for European societies in the 21st century. The proportion of people over the age of 65 in the European Union countries will increase to around 29 % by 2080 compared to around 19 % in 2017 (Eurostat, 2018). As populations age, also entrepreneurs age. Aging has potential impacts on both firm growth and firm continuity. Firm growth is a complex phenomenon not easily explained, and the impact of the entrepreneur's age on firm growth is not clear-cut. However, studies have shown a link between the entrepreneur's growth motivation and actual growth (Kolvereid & Bullvås, 1996; Miner, Smith & Bracker, 1994; Halttunen, 2004). According to Gray's (2004) results, growth orientation is at its highest for entrepreneurs under 40 and generally declines with age, although many entrepreneurs retain their interest in growth and innovation past the age of sixty.

Firm continuity also becomes an issue as the entrepreneur ages. When the time comes for the entrepreneur to retire, either firm continuity must be ensured (i.e., ownership transfer takes place) or the firm – along with its contribution to economic activity and employment – ceases to exist. Furthermore, it appears that compared to start-ups, successfully transferred businesses have better performance in terms of survival, turnover, profit, innovativeness and employment (e.g. Van Teeffelen, 2012; Meijaard, 2007). This makes business transfers extremely important not just for the firms involved but also for the society in general. Furthermore, there is evidence that even prior to the actual business transfer, continuity outlook, i.e. the firm's expectation of continuity, has an impact on the growth intentions of a firm (Varamäki et al., 2018).

It also should be noted that there are different ways of accomplishing a business transfer. According to surveys, 20-25% of SMEs expect to find a successor within the family while almost 40% are looking for external buyers (Varamäki, Tall, & Viljamaa, 2014; Battisti & Okamuro, 2010). However, despite extensive research into succession planning (e.g. Le Breton-Miller, Miller & Steier, 2004), little is known about the connection between growth orientation and succession planning.

Development activities in firms can be conceptually separated into exploration and exploitation (March, 1991), the former relating to development and innovation outside present strategy and markets, and the latter to improving of current processes, activities and products. The two types of development activities relate to firm growth as well as firm continuity. Exploration and exploitation have different time perspectives and impacts on firm performance (Raisch & Birkinshaw, 2008). This makes good sense: exploration activities are more unpredictable and uncertain whereas exploitation delivers more predictable, faster results.

It also appears that different continuity outlooks (succession vs. external buyers) are related to the firm's exploration/exploitation activities (Varamäki, Tall & Viljamaa, 2014). In this study we examine the impact of a firm's continuity outlook and development activities on growth intentions. Specifically, the objectives are to examine 1) the effect of different continuity outlooks of the firm on growth intentions, 2) the effect of exploration and exploitation activities on growth intention, and 3) the differences in exploration and exploitation activities between different continuity outlooks of the firm.

2. Conceptual development

2.1 Continuity outlook and growth intentions

A business transfer is here defined as a change of ownership of any firm or business to another person or legal entity assuring the continuous existence and commercial activity of the enterprise when more than 50 % of the assets or shares are transferred (see e.g., Van Teeffelen, 2012, 2010; Sten, 2006). This definition includes all varieties of business transfers, and it includes both a change in ownership and in management (Van Teeffelen, 2012; European Commission, 2002). By succession we mean the process through which a predecessor assigns authority and ownership of business activities within the family to the next generation or to their spouse (successor) (see also Hautala, 2006; Sharma *et al.*, 2001).

Previous business transfer and succession studies have investigated strategic renewal, i.e. the successor's capability to innovate and reorganize the firm and business after taking the responsibility (e.g., Agarwal & Helfat, 2009; Niemi, 2005; Barney, 2001; Priem & Butler, 2001; Haspeslagh & Jemison, 1991). However, the development efforts and growth orientations of forthcoming sellers and predecessors before the transfer have received little research attention (Varamäki, Tall & Viljamaa, 2014).

Continuity outlook is defined here as the expectation of what will happen to the firm as the current entrepreneur withdraws from the firm. We consider four different continuity outlooks of a firm to be: a) succession, b) co-owners continue the firm, c) selling the firm outside the family and d) closing down the firm. Intuitively, one would expect closing down the firm as the continuity outlook least likely connected with growth intentions. Applying the same idea a bit further, one would expect a close connection between current and future management to contribute to growth intentions positively; if a family member or a co-worker is expected to

continue the firm, there is a more definite expectation of continuity and hence growth intentions should be greater.

Growth intentions are important for the society. In this research, the growth intentions are defined as the firm's goal for future growth in turnover. Levie & Autio (2013) conclude that the proportion of entrepreneurs with growth intentions in the population is a more significant predictor of economic growth than general start-up rates or self-employment rates. In addition, they show in a meta-analysis that growth intentions have a direct effect on subsequent realised growth. Growth intentions have also a positive impact on sales growth (Cesinger, Gundolf & Géraudel, 2018). Thus, it is important to understand what factors have effect on growth intentions. Previous research have shown that entrepreneur's cognitive style moderates the relationship between perceptions of the competitive environment and growth intentions (Dutta & Thornhill, 2008) and growth intentions are affected by career stage and family status with gender variations (Davis & Shaver, 2012). At the individual level, entrepreneurs' growth intentions are a consequence of individual characteristics (risk-taking, achievement orientation and innovativeness), and more weakly affected by environmental effects (Levie & Autio, 2013). In addition, psychological capital (especially hope and self-efficacy) has a positive effect on growth intentions of entrepreneur (Hizam-Hanafiah, Yousaf & Usman, 2017). However, there is a lack of research on the effects of continuity outlook of the firm.

Our question is:

Q1: What is the strength of relationship between continuity outlook and growth intentions?

2.2 Exploration and exploitation

The conceptual divide in development activities in exploration and exploitation (March, 1991) has been widely applied in management research (e.g, Lavie & Rosenkopf, 2006; Levinthal & March 1993). Exploration includes search, discovery, experimentation, variation, flexibility, radical innovation and risk-taking characteristics of the firm behavior (He & Wong, 2004; Chen & Van de Ven, 1996; March 1991). Exploration orientation is connected to experimentation in order to make radical innovations, to create 'innovative technologies' (Lubatkin, Simsek, Ling & Veiga, 2006), new markets and processes that emerge outside the current knowledge and strategies (Lumpkin & Dess, 1996; Siren, Kohtamäki & Kuckertz, 2012). By contrast, exploitation is aimed to contribute to the firm success by improving management of existing resources and technologies (Benner & Tushman, 2003). Exploitation is performed through routinization, efficiency, stability, competence and focus (Holmqvist, 2004). It can be argued that firms need both of these development activities for present and future viability. Excessive exploitation can lead to situation where a firm is not able to respond environmental changes adequately and on the other hand, too much exploration may harm the firm's current viability (Kim & Huh, 2015). Piao (2014) suggests, that firms need to actively engage in both exploitation and exploration activitites in order to prolong their lifespan.

These different types of development activities are also related to firm growth. For example, Colombelli, Kraft and Quatraro (2012) showed that high-growths firms follow predominantly an exploration strategy. Hence, one would also expect that with high growth intentions, development activities associated with exploration are preferred. No studies have been found on the connection between continuity outlooks and development activity focus. However, as we surmise assured continuity is connected with higher growth intentions, we similarly expect

that the more definite continuity outlooks, i.e. succession and co-workers continuing the firm, to be associated with greater emphasis on exploration activities. In exploration oriented development activities, future opportunities are sought at the expense of today's operations (Birkinshaw & Gibson, 2004). This makes sense only if the firm has a foreseeable future. The more assured of continuity the firm is, the more it can rationally consider distant profits gained through exploration at the expense of present profits that might be available through exploitation focus.

Our questions are:

Q2: What is the strength of relationship between exloration/exploitation activities and growth intentions?

Q3: Are there differences in exploration/exploitation activities between different continuity outlooks?

3. Methodology

3.1 Data collection

The data for the study were collected in May-August 2018 as a web-based survey to owners and CEOs of Finnish small and medium-sized enterprises. The target group consisted of the entrepreneurs in the age group over 55 years. The age group was chosen, because in Finland the most common age bracket for retirement is 60–64 years, and the aim of the study was to investigate future outlook of firms owned by aging entrepreneurs. It is reasonable to assume that the entrepreneurs' views on firm continuity are more credible within ten years of retirement age than before, and that potential for family succession has been considered if it is an option. The web-survey was sent to members of the Federation of Finnish Enterprises, to members of the Confederation of Finnish Industries and the members of Finnish Chambers of Commerce. A total of 1 742 responses were received, of which 929 represented the targer group of over 55 years.

3.2 Measurement constructs

The scales for this questionnaire have been proposed and tested using Finnish regional data in 2010 (Varamäki et al., 2010). Growth intentions were measured with 4-point ordinal scale. The respondents were asked the question: "How would you describe the growth intentions of your firm?". The options were 1) No growth intentions, 2) Maintaining the current market share (the annual growth in turnover some percentages), 3) Seeking moderate growth (the annual growth in turnover at least 10 percent) and 4) Seeking high growth (the annual growth in turnover at least 30 percent).

Continuity outlook of the firm were measured with nominal scale. The respondents were asked the question: "What do you think your firm's future will be after you have given up the main responsibility of it?" Please, choose the most probable option: (1) Succession inside the family, (2) Co-owners will continue the firm, (3) Selling the firm outside the family and (4) Closing down the firm.

Exploration/Exploitation activity were measured with scale adapted from He & Wong (2004). Respondents were asked what development activities in the firm they emphasize at the present moment. The scale used 5-point Likert scale, 1 referring to "not at all an emphasis" and 5 referring to "a strong emphasis". Variables measuring exploration activity were: a) Introduce new generation of products, b) Extend product range, c) Open up new markets, and d) Enter new technology fields. Variables measuring exploitation activity were: a) Improve existing

product quality, b) Improve production flexibility, c) Reduce production cost, d) Increasing the efficiency of operations, and e) Outsourcing operations. The reliability of the scales were acceptable. Cronbach's alpha for exploration activity was 0.78 (minimum 1, maximum 5, standard deviation 0.9) and for exploitation activity 0.79 (minimum 1, maximum 5, standard deviation 0.9).

3.3. Data description and analysis

Of the respondents 69 percent were male and 31 percent were women. The ages of the respondents ranged from 56 to 82 years with an average of 61 years. 29 percent were 56-58 years old, 33 percent were 59-62 years old, 19 percent were 63-65 years old and 20 percent were 66 years old or older. 43 percent had a degree from higher education and 42 percent had a degree from vocational education. 15 percent of the respondents did not have a degree from either.

25 percent or the firms one-person-enterprises. 33 percent had 2–4, 21 percent had 5–10, 9 percent had 11–20, 6 percent had 21-50 and 4 percent had over 50 employees. The industries of the firms were: 52 percent services, 20 percent retail trade, 14 percent construction and 14 percent manufacturing.

For answering research questions 1 and 2 we used ordinal regression analysis. In ordinal regression analysis, dependent variable is ordinal (growth intentions). Independent variables may be continuous, ordinal or categorical. In our analysis, continuity outlook is a categorical variable and exploration/exploitation activities are continuous variables. Ordinal response Y represents levels of growth intentions (no intentions, maintaining market share and mild growth, moderate growth, high growth). Ordinal regression analysis can be used to identify the strength of the effect that the independent variables have on a dependent variable (Agresti, 2013).

For answering research question 3 we used analysis of variance (ANOVA). ANOVA examines the potential differences in a scale-level dependent variable by a nominal-level variable having 2 or more categories. In our study, the scale-level dependent variable is exploration/exploitation activity and the nominal-level variable continuity outlook. Table 1 presents the correlation table for study variables using Spearman's correlation.

Table 1. Correlations for study variables (Spearman's correlation)

	Growth intentions	Exploration activity	Exploitation activity
Growth intentions	1,000		
Exploration activity	,484**	1,000	
Exploitation activity	,283***	,438***	1,000
Continuity outlook	-,335***	-,195***	-,151***

*** Correlation is significant at the 0.001 level (2-tailed)

4. Results

Table 2 presents first the case processing summary. 16 percent of the firms answered that they had no growth intentions. 43 percent wanted to maintain the current market share, 34 percent were seeking moderate growth and only 7 percent were seeking high growth. 24 percent had succession as a continuity outlook, 8 percent estimated that co-owners will continue the firm, 47 percent were planning to sell the firm outside the family and 21 percent answered that they will close down the firm.

Table 2. Case processing summary		
	N	Marginal percentage
Growth intentions		
No growth intentions	137	16,0 %
Maintaining the current market share	366	42,8 %
Moderate growth	290	33,9 %
High growth	62	7,3 %
Continuity outlook		
Succession	208	24,3 %
Co-owners will continue the firm	67	7,8 %
Selling the firm outside the family	401	46,9 %
Closing down the firm	179	20,9 %

Table 3 presents the results of the ordinal regression analysis. The proportional odds model shows the positive effect of exploration activity (β=1,142) which is statistically significant (p=0,001) according to Wald test (Wald 150,661). The cumulative odds ratio is exp (1,142) = 3,13, which means that when exploration activity increases one unit, there is an increase of 3,13 times the opportunity to have higher growth intentions. However, exploitation activity does not have a statistically significant effect according to Wald test (Wald 3,815, p=0,051).

Model shows the positive effect of succession as a continuity outlook (β=1,784) on growth intentions, which is statistically significant (p=0,000) according to Wald test (Wald 68,592). The cumulative odds ratio is exp (1,784) = 5,95, which means that when moving from the category "closing down the firm" to "succession", there is an increase of almost six times the opportunity to have higher growth intentions. The model also confirms the positive effect of continuity outlook of "co-owners will continue the company" (β=1,978). Wald estimate is 45,436 with statistically significant test result (p=0,000). The cumulative odds ratio for co-owners continuing the firm is exp (1,978) = 7,23, which means that when moving from the category "closing down the firm" to "co-owners will continue the firm", there is an increase of over seven times the opportunity to have higher growth intentions. In addition, also selling the firm outside the family as a continuity outlook has a positive effect on growth intentions (β=1,495), which is statistically significant (p=0,000) according to Wald test (Wald 61,475). The cumulative odds ratio is exp (1,495) = 4,46. This means that when moving from the category "closing down the firm" to "selling the firm outside the family", there is an increase of 4,5 times the opportunity to have higher growth intentions. The ordinal regression analysis shows that there is a strong relationship between different continuity outlooks and growth intentions. Compared to closing down the firm, the continuity outlooks of "co-owners continuing the firm" and "succession" increase growth intentions the most.

The model fit to the data, goodness of fit produces Chi-Square value of 1210,322 with significance value of 0.468. The adjustment of goodness is found for all observations. The explanatory variables improves the model, because of unexplained variation decreases from 1616,695 in the model with only a constant, to 1245,649. The difference (371,046) is statistically significant (p=0,000). There is a strong evidence of association between the study variables. Nagelkerke value for the model is 0,386, Cox and Snell 0,352 and McFadden 0,179.

Table 3. Results from the ordinal regression analysis.

		Estimate	Std. Error	Wald	df	Sig.	95% Confidence Interval Lower Bound	95% Confidence Interval Upper Bound
Threshold	[growth intentions = 1,00]	3,115	,332	88,218	1	,000	2,465	3,766
	[growth intentions = 2,00]	5,956	,383	241,645	1	,000	5,205	6,706
	[growth intentions = 3,00]	8,561	,429	398,183	1	,000	7,720	9,402
Location	Exploration activity	1,142	,093	150,661	1	,000	,959	1,324
	Exploitation activity	,179	,092	3,815	1	,051	-,001	,360
	[Succession]	1,784	,215	68,592	1	,000	1,362	2,206
	[Co-owners continue]	1,978	,293	45,436	1	,000	1,403	2,553
	[Selling the firm]	1,495	,191	61,475	1	,000	1,121	1,869
	[Closing down]	0[a]	.	.	0	.	.	.

Link function: Logit.

a. This parameter is set to zero because it is redundant.

The differences in exploration/exploitation activities between different continuity outlooks were tested with variance analysis. There were differences between the groups as determined by one-way ANOVA. For exploration activity, estimates were F(18,452), p=0,000 and for exploitation activity F(15,192), p=0,000. Table 4 shows the mean values of different groups. The highest mean values in exploration activity are with the continuity outlooks of "co-owners will continue the firm" (mean value 3,5) and "succession" (mean value 3,2). Also in exploitation activity, these same continuity outlooks have highest mean values (mean value for co-owners continuing the firm 3,6 and succession 3,5). Not surprisingly, the lowest values in exploration and exploitation activities have firms with the continuity outlook of closing down the firm (mean values 2,7 for exploration activity and 3,0 for exploitation activity).

Table 4. Differences in exploration/exploitation activity between different continuity outlooks.

Continuity Outlook	Exploration activity	Exploitation activity
Succession	3,2 (n=214)	3,5 (n=216)
Co-owners will continue the firm	3,5 (n=67)	3,6 (n=67)
Selling the firm outside the family	3,0 (n=412)	3,4 (n=414)

Closing down the firm	2,7 (n=182)	3,0 (n=186)
Sig.	***	***

*** indicates a significance at the 0.001 level (2-tailed).

5. Conclusions

The first objective of this study was to examine the effect of different continuity outlooks of the firm on growth intentions. Our results show that there is a strong relationship between different continuity outlooks and growth intentions. Compared to closing down the firm, the continuity outlooks of "co-owners continuing the firm" and "succession" increase growth intentions the most. This confirms our intuition that definite, assured continuity with known individuals set to benefit from growth are more strongly associated with growth intentions. Furthermore, one may surmise that with co-owners continuing the firm, the future owners are actively involved in making growth-related decisions along with current owner, and may influence such decisions with their longer perspective on firm future. Growth intentions are also clearly related to succession as continuity outlook. This is understandable as close family members may psychologically appear as extensions of self to the extent that benefit to them counts as benefit to self; there is no slacking off in firms' growth intentions when the expected beneficiary of growth is a family member.

The second objective of this study was to examine the effect of exploration and exploitation activities on growth intentions. Our results demonstrate a strong link between exploration and growth intentions. The more a firm emphasizes exploration in its development activities, the more strongly it also seeks growth – or vice versa. This is in line with previous research by Colombelli, Kraft and Quatraro (2012), who showed that high-growths firms follow predominantly an exploration strategy. In addition, this result supports the theoretical assumption that growth intentions of the entrepreneur predict activities conducted in pursuing growth and this involves goal-directed behavior (Stenholm, 2011). It is noteworthy that our results confirm the connection between growth intentions and exploration in context of 55 plus entrepreneurs. Even in this age group, entrepreneurs still seek growth through exploration of new territories.

The third objective of this study was to examine the differences in exploration and exploitation activities between different continuity outlooks of the firm. Our results show, that exploration activities and continuity outlooks have a clear linkage. The highest mean values in exploration activity are with the continuity outlook of co-owners continuing the firm, with succession having the second strongest connection with exploration activities. Also in exploitation activity, these same continuity outlooks have highest mean values. Not surprisingly, the lowest values in exploration and exploitation activities have firms with the continuity outlook of closing. This result is in line with the previous study of Varamäki *et al.* (2014). They also found that continuity outlook influenced development activities: firms planning business transfer within the family or firms with co-owners planning to continue the business were the most active in both types of development. This is notable, because from the longevity aspect, firms need to engage in both exploration and exploitation activities (Piao, 2014).

Thus, the continuity outlook of a firm is connected with the overall level of development activity. This may indicate that firms with assured future are better positioned to maintain a balanced strategy in development activities. According to March (1991), results of exploration

are unpredictable, uncertain and distant, while results of exploitation are more certain, positive and closer in time (March 1991). Having not only the present but also the future to consider, entrepreneurs with definite continuity outlooks expend effort on development in both directions.

The results show that having a definite continuity outlook is highly important for firms under management of aging entrepreneurs. If there is no clear idea of how the firm will continue, development efforts will be less energetic. Previous studies indicate, that continuity outlook is influenced by individual characteristics of the owner (gender, educational background, own experience) and by firm characteristics (firm size and the line of business) (Varamäki *et al.* 2016). It is important to understand these factors in order to enhance business transfers. This requires awareness raising in the society. Successful business transfers are important for the society, but in addition, for the individual. Especially with family firms, retirement well-being expectation is tied to the performance of the family firm (Collins, Worthington & Schoen, 2016).

All in all, positive continuity outlooks of the firm and thus expected business transfers, growth intentions and active development of the firm strongly correlate and co-exist. From the business policy point of view it is important to recognize that enhancing SME business transfers is the best possible growth entrepreneurship promotion.

There exist some limitations in this research. The data represents entrepreneurs from one country and thus, the results can not be generalized in every culture. In addition, it is possible that this web-based survey resulted answers from such entrepreneurs that are already interested in business transfers and this may have an effect on the firm profiles. Regardless of these limitations, the dataset is considerable and the results offer new insights on business transfers and growth intentions.

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