

Impact of effective governance structure on succession process in the family business: exploring the mediating role of management succession planning

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Abstract

Purpose – The aim of this research is to analyze empirical evidence of the effect of governance structure (GS) on perceived success of the succession process. It is also reported that in India, family firms have a more informal organization structure and governance and have an informal and unplanned approach to bringing the successors into family business. Previous studies have reported that GS is an important factor for a successful succession process. This study examines the role of management succession planning as an intervening variable to achieve perceived success of the succession process.

Design/methodology/approach – Data have been collected using a questionnaire schedule with 113 respondents who are successors from family business firms in Kerala, India. The study uses snowball sampling technique. Partial least square-structural equation modeling has been used to do data analysis.

Findings – The results of the study showed that GS has a significant positive effect on the success of the succession process. GS has a significant positive effect on management succession planning. Management succession planning partially mediates the relationship between GS and perceived success of the succession process.

Research limitations/implications – The results of the study indicate the effect of GS on the relationship between, perceived success of the succession process and management succession planning. The mediating role of management succession planning in the above relationship is also confirmed. Therefore, before starting the succession process a good GS should be put in place for ensuring the success of the succession process. Family firms must implement the succession plan well to make the succession process successful.

Originality/value – The main contribution of the study is to empirically investigate the effect of GS and management succession planning to enhance the success of the succession process.

Keywords Family business, Management succession planning, Perceived success of the succession process, Governance structure

Paper type Research paper

1. Introduction

Family businesses represent a dominant form of the economic organization worldwide (Beckhard and Dyer, 1983; Shanker and Astrachan, 1996). Family firm owners play an



important role in creating wealth and job opportunities across the globe (Venter *et al.*, 2005). Small and medium-sized firms constitute a significant portion of the family business (Bjuggren and Sund, 2001; Gersick *et al.*, 1997; Hume, 1999). Churchill and Hatten (1987) explained a family business as “a founder-operated business where there is anticipation that the business will be passed to the next generation”.

The transfer of ownership and management from the first to the second generation is considered more complicated, and for this very reason, succession has become challenging (Bjuggren and Sund, 2001; Stavrou, 1999). The tremendous influence of the succession process motivated scholars to explore various owner, successor, family, process and organization-related factors. Governance structure (GS), organization-related factor plays a crucial role in the perceived success of the succession process. A proper governance mechanism enhances harmony, creates commitment among family members and finally leads to firm success (Brenes *et al.*, 2011). The governance process encompasses different activities and interactions among actors in the GS, and it consists of activities like “social interactions, institutional forces and cultural patterns” (Nordqvist and Melin, 2002).

Succession planning is an intricate process and involves interactions of personal, relational and organizational factors, and it includes individual and career development of prospective successors, succession planning and control activities (Francis, 1993). A study conducted among Taiwanese family businesses found that the main reasons for failing to adopt a succession plan are the absence of a succession planning department, adverse effects of succession, small organization size, top management not prioritizing succession plan contents and procedures (Huangs, 1999). From the above case, we can infer that the top management does not properly conceive the importance of GS and they were least interested in succession plans.

1.1 The research gap addressed in the study

There is general agreement in the literature that GS and proper management succession planning are important factors impacting the success of the succession process. In the survey conducted by Rajkumar *et al.* (2013) in Kerala, formal succession planning was sporadic, and succession plans were in the owner’s mind and hardly discussed even with the spouse. Meanwhile, family business courses, conferences and workshops conducted on this topic by the Chamber of Commerce and Confederation of India Industries in Kerala have improved the awareness about the importance of GS and management succession planning. But no studies have been conducted to verify this and investigate the mediating role of management succession planning on GS and perceived success of the succession process.

The changes in the generational outlook make a difference in managing the family business, making conventional methods of succession and governance no longer suitable. The experience of new generation entrepreneurs in the changing market scenario worldwide has induced new thoughts related to the family business structure. These professional approaches lead them towards a formal planning and GS. There is hardly any study done to study these recent changes happening in family businesses.

This study, therefore, tries to bridge the gap discussed above. It is devoted to studying the impact of GS on the perceived success of the succession process, mediated through management succession planning.

1.2 Line of enquiry

From the research gap identified, there arises a question regarding how influential the relationship between GS, management succession planning and perceived success of succession process in the current market scenario from the viewpoint of the successor?

The remainder of this paper is structured as follows: section 2 describes the literature review and development of the hypothesis; section 3 discusses the research methodology and

measurements; section 4 presents the analysis and the last section covers discussions, conclusions, limitations and suggestions for future research.

2. Literature review and hypothesis development

The satisfaction of all family members regarding the succession process and the potential of a successor to run the firm by maintaining a stable financial status and longevity are essential to ensure a successful succession process (Venter, 2003).

GSs set the standards and controls for how the business operates and how the people in it conduct themselves (Hough *et al.*, 2008). A family business with good family governance practices formulates specific policies or mechanisms to settle disputes, leading to a harmonious relationship among the family members (Carlock and Ward, 2001). An effective governance mechanism implemented in a firm may make the intergenerational transition process easier and lead to family business longevity (Groysberg and Bell, 2014). The perceived success of the succession process is defined as “a subjective assessment of an individual about the process based on perceptions instead of objective criteria” (Sharma *et al.*, 2001).

In a research study done among owners in the Indonesia tour and travel sector, the absence of GS is one of the causes for the family firm’s failure. There is a direct linkage between corporate governance and the performance of succession. Succession creates problems of non-technical as it involves certain emotional aspects (Parada *et al.*, 2020). Ward (2004) pinpointed that governance mechanisms like family meetings and forums help to solve communication problems. There is a need for a strong GS to ensure family business longevity (Pieper *et al.*, 2003). Only a few pieces of research have been done witnessing the linkage between GS and family business success. It is noticed that family business governance is an intricate process, unlike non-family firms. It is mainly because of the need to manage the dual relationships (family and business relationships). Even though it is essential to examine the effectiveness of the governance institutions like family protocols and councils for success in the family business, not much research is done (Ceja *et al.*, 2011).

Therefore, it is hypothesized that.

- H1. There is a positive relationship between governance structure and the perceived success of the succession process.

According to File and Price (1996), management succession planning refers to “the process of making changes in the top leadership of the business, a process which begins when younger family members first join the business and ends with their accession to leadership and top management authority.” The majority of the successors with less experience were placed in the lower positions though highly educated (Morris *et al.*, 1996). There is no noted criterion to induct the successor. Constitution is an integral part of a family firm, and rejection apparently denies the management succession plan. The absence of a good generational succession plan and family governance plan is more harmful to a family business than any other negative influence. The recent studies also highlighted the importance of a governance system, and they act as a catalyst of a succession support system (Arteaga and Menéndez-Requejo, 2017). The governance practices play an essential role in the process of succession. Some of the reasons are First, a suitable governance mechanism helps to develop the required skill, competencies and capabilities of the prospective successors to manage and control the family business (Berent-Braun and Uhlaner, 2012; Suess, 2014). Second, other governance mechanisms such as family councils and meetings help to resolve the disputes (Lansberg, 1988; Le Breton-Miller *et al.*, 2004). Third, governance practices like family charters, family councils and informal meetings prescribe guidelines for family members’ involvement in the family business (Arteaga and Menéndez-Requejo, 2017). Adendorff (2004) finds a positive relationship between

management succession planning and perceived good governance. It implies that the more a family plans for management succession, the more influential the family business is in controlling risk, managing the internal regulatory environment and preserving stakeholder interest.

So, it is hypothesized that.

H2. Governance structures have a significant effect on management succession planning.

[Seymour \(1993\)](#) suggests that the existence and continuity of a family business are affected if the succession plan is absent. [Christensen \(1953\)](#) believes that the prospect of achieving profit is more if they had drafted a succession plan, explicitly communicating to all the members. Many family business owners show reluctance to create a succession plan even though they know its importance ([Lansberg, 1988](#)). Founders play an essential role in formulating a succession plan, but it is harder to frame an effective plan later ([Ward, 1987](#)). [Upton et al. \(2001\)](#) cited that succession is considered a mechanism to maintain family control over the firm and ensure rapid development to enhance family wealth. Though so much literature reminds us of the dangers of a flawed succession plan, most owners still keep an attitude of denial towards it ([LeonGuerrero et al., 1998](#)).

In another study by [Allen and Panian \(1982\)](#), there is no linkage between business performance and succession management, especially in a family business managed and controlled by families, especially during low profitability. In another contradictory study, [Astrachan and Kolenko \(1994\)](#) found that family meetings, strategic planning and board of directors lead to the family business's longevity, not management succession planning. Based on contradictory evidence, it is hypothesized that:

H3. Management succession planning has a significant effect on the perceived success of the succession process.

Many researchers believe that family gatherings, councils and the Board of Directors play an essential part in successful succession planning ([Jaffe and Lane, 2004](#)). A suitable governance mechanism is executed to meet the needs of succeeding generations and develop the business future ([Venter and Boshoff, 2007](#)). Through a proper and efficient GS, conflict situations during the succession process might get avoided ([Martin, 2001](#)). If a proper and efficient governance mechanism indicates the family firm's intention to continuity, they start steps to begin the succession planning process ([Umans et al., 2020](#)). The top management of the family business must initiate steps to introduce proper succession planning activities through governance mechanisms like family councils, family constitution and family meetings. It ultimately leads to a successful succession process.

Therefore, it is hypothesized that

H4. Management succession planning mediates the relationship between governance structure and perceived success of the succession process.

The research model used in the study is shown in [Figure 1](#). This simple mediation model describes the relationship between the variables, namely: (1) GS, (2) management succession planning (MSP) and (3) perceived success of the succession process (PSS). It also explains the mediating role of management succession planning on the relationship between GS and the perceived success of the succession process.

3. Methodology and measurements

3.1 Research design

In this study, we have employed a quantitative research design. A partial least square structural equation model (SEM) is used to test the hypothesis. The unit of observation and

study is a business family. Age of family firm and size of the family business measured in terms of turnover are the control variables used in the study.

3.2 Data collection

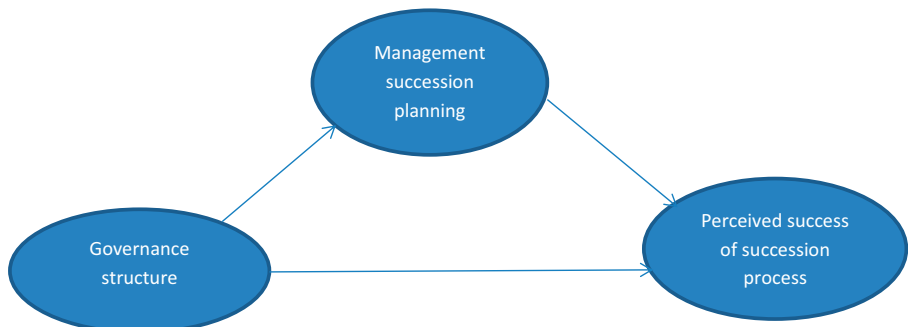
Data were collected using a questionnaire schedule. The inclusion criterion for family business firms was the initiation of management transfer to the next generation. Snowball sampling method used in the study as no source provides the complete list of family businesses in Kerala; moreover, without a reference, the respondents show reluctance to participate, since the data collection process constitutes complex and emotional issues of succession. A few businesses known to the researcher and their contacts were approached first for participating in the survey. The researcher surveyed successors, references they gave were contacted in the first round and used to create a list of potential respondents for the next round. These potential respondents are contacted through telephone to seek their permission for the survey. This proved to be an effective approach for collecting data relating to the family business. Successors of one hundred and thirteen business families are contacted for data collection purposes. All the data collected were useable for the study. Thirty-one business families though contacted through reference, did not participate in the study.

3.3 Measurements

The schedule used in this study was designed in two parts: the first part concerned the respondents' business profile. The second part contains 17 items measuring the three theoretical constructs: management succession planning, GS and perceived success of the succession process. In the business profile, data were collected regarding the age and size of the family business (Table 1). All the constructs and their respective items were adapted from the existing literature to establish content validity. The GS scale was measured with six items adapted from (Van der Merwe *et al.*, 2012). The fifteen-item scale developed by Sharma *et al.* (2003) for succession planning was adapted to measure management succession planning. Out of the total 15 items, five items related to management succession planning were extracted. Six item scale developed by Venter *et al.* (2005) was used to measure the dependent variable perceived success of the succession process (Table 2). It is a well-established scale that is widely used in different studies of the family business. In this paper, we have not taken the objective measure of performance while measuring the dependent variable.

Expert validation was done to ensure the content validity and reliability of the scale items. Content validity was done by a review panel consisting of two faculty members who are experts in methodology and analysis. Two successors were also consulted who have taken specialization courses in the family business, and two well-reputed owners who have

Figure 1.
Model proposed for linkages between governance structure management succession planning and perceived success of the succession process



Turnover of firm	No. of respondents	Percentage (%)
1–20 crore	70	62
21–40 crore	24	21
41–60 crore	5	4
61–80 crore	7	6
81–100 crore	3	3
101–120 crore	2	2
Above 120 crore	2	2
Total	113	100

Age of firm	No. of respondents	Percentage (%)
10–30 years	10	9
31–60 years	54	47
61–90 years	36	32
Above 90 years	13	12
Total	113	100

Table 1.
Business profile of
respondents

Governance structure (Van der Merwe et al., 2012)

- 1) The family has a family forum that meets to discuss family and business matters
- 2) Our family business has a formal document that describes the relationship between the family and the business
- 3) Family members hold regular scheduled meetings concerning our family business
- 4) Our family business has written plans to guide actions and decisions in the business
- 5) Our family business has a standing agreement on how to address issues that may arise in the business
- 6) We undertake formal strategic planning for our family business

Management succession planning (Sharma et al., 2003)

- 7) During the succession process explicit efforts are made to train successor for future role in the family business
- 8) During the succession process explicit attention is given to familiarize successor with employees in the family business
- 9) The decision of who the successor has been clearly communicated to family members active in the business
- 10) The decision of who the successor had been clearly communicated to the key employees
- 11) During the succession process explicit attention was given to familiarize the potential successors with the business

Perceived success of succession process (Venter et al., 2005)

- 1) The family business has performed well or better since the management/leadership of the business transferred to successor
- 2) The family business has proved to be sustainable since the management/leadership of the business transferred to successor
- 3) The relationship among family members are positive after the management/leadership of the business transferred to successor
- 4) All family members involved in the family business are satisfied with succession process
- 5) The retired owner satisfied with succession process
- 6) I improved the revenue and profits of the family business after the leadership or management of the business handed over to successor

Table 2.
Scale items

completed their transition to the next generation. The individual items of three variables that show low reliability were deleted after considering the content validity. Finally, the reliability of the three constructs, GS, Management succession planning and perceived success of succession process, have reliability values higher than 0.7 (Table 3).

The descriptive results have shown that there is enough coverage over the whole region of the scale three variables in the study GS ($M = 2.96$, $SD = 0.899$), management succession planning ($M=3.01$, $SD = 0.648$) and perceived success of the succession process ($M = 3.64$,

Latent variable	Loading	p-value
<i>Governance structure (composite reliability = 0.839); (AVE = 0.511)</i>		
GS1	0.661	<0.001
GS2	0.857	<0.001
GS3	0.870	<0.001
GS4	0.915	<0.001
GS5	0.622	<0.001
GS6	0.910	<0.001
<i>Management succession planning (composite reliability = 0.883); (AVE = 0.606)</i>		
MSP11	0.874	<0.001
MSP12	0.863	<0.001
MSP13	0.646	<0.001
MSP14	0.642	<0.001
MSP15	0.834	<0.001
<i>Perceived success of succession process (composite reliability = 0.939); (AVE = 0.767)</i>		
PSS16	0.826	<0.001
PSS17	0.866	<0.001
PSS18	0.823	<0.001
PSS19	0.906	<0.001
PSS20	0.917	<0.001
PSS21	0.910	<0.001
Note(s): CR of 0.70 or more: sufficient reliability. (2) AVE of 0.50 or more: convergent validity		

Table 3.
Results of composite
reliability and
convergent validity

SD = 0.858) as the mean and SD are in the normal range. The slightly lower mean of GS indicates that GS still needs more strengthening, management succession planning is being done much better now, and the business families have a very optimistic perception regarding the success of the succession process.

4. Empirical results

4.1 Measurement model analysis

We use measurement model analysis to assess the reliability and validity of the measures relating to specific constructs. To consider nonlinearity when estimating the coefficient of association among interconnected variables, WARP PLS 7.0 is also employed (Kock, 2016).

The whole measures are significant as the loading level is above 0.60, and there is a minimum sixty percent variance in the underlying three latent variables, as shown in Table 3 (Chin, 1998). The whole measures are reliable as the composite reliability coefficients for the constructs are more than the acceptable level of 0.70 (Nunnally, 1967; Hair *et al.*, 2014). We use convergent and discriminant validity to assess the construct validity. Average variance extracted was used to assess convergent validity. The average variance extracted for all the constructs was above 0.50, shown in Table 3. This study provides evidence for convergent validity (Hulland, 1999).

Table 4 shows the discriminant validity analysis. It is an important measure to define different concepts. It explains whether the constructs are unrelated to each other. It is usually done by comparing the square root of AVE with the correlation between the constructs. The square root of AVE of a construct is higher than the correlation between the construct, indicating adequate discriminant validity (Fornell and Larcker, 1981). As shown in Table 4,

the correlation among the constructs in the off-diagonal and the square root of AVE in the diagonal indicate adequate discriminant validity.

4.2 Structural model analysis

This method does not consider normality assumption, and therefore, it is suitable in cases where the sample size is small (Hair et al., 2014). Mediation model testing tests the direct effect before inserting a mediating variable (Baron and Kenny, 1986) and (Hair et al., 2011). The result of the direct effect must be significant. Table 5 (Panel A) supports the first hypothesis, stating that GSs are positively associated with the perceived success of the succession process ($\beta = 0.47; p < 0.01$).

In the second step, we introduce MSP as a mediating variable. Table 5 shows the results of the structural model analysis. According to Hair et al. (2010), the following requirements of the mediating effect should be met: (1) the path coefficient from the independent variable to the dependent variable is significant; (2) the path coefficient from the independent variable to the intervening variable is significant and (3) the path coefficient from the intervening variable to the dependent variable is also significant. Before introducing MSP as the mediating variable, the path coefficient of GS > PSS was significant ($\beta = 0.47; p < 0.01$). After introducing MSP, the path coefficient of GS > PSS was still significant ($\beta = 0.29; p < 0.01$), but the beta value is reduced from 0.47 to 0.29. This indicates that MSP partially mediates the relationship between GS and perceived success of the succession process. The structural model is shown in Figure 2.

5. Discussions

In the study, we have enquired into the mechanism through which GS affects the perceived success of the succession process via proper implementation of management succession plans. An effective GS with a good management succession plan makes the transition process

Variables	GS	PSS	MSP
GS	0.687		
PSS	0.250	0.876	
MSP	0.073	0.288	0.779

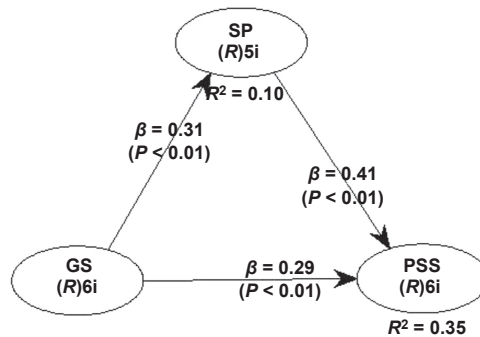
Note(s): Discriminant validity: diagonal elements > respective off-diagonal elements

Table 4. Discriminant validity

Direct effect	Beta coefficient	Probability	Decision
<i>Panel A</i>			
<i>Before including MSP as mediating variable</i>			
GS > PSS	0.47	$p < 0.01$	Significant
<i>Panel B</i>			
<i>After introducing MSP as mediating variable</i>			
GS > PSS	0.29	$p < 0.01$	Significant
GS > MSP	0.31	$p = 0.01$	Significant
MSP > PSS	0.53	$p < 0.01$	Significant
<i>Panel C</i>			
	<i>Indirect effect</i>	<i>Probability</i>	<i>Decision</i>
GS > MSP > PSS	0.18	$p < 0.01$	Significant-Partial mediation

Table 5. Summary of structural model analysis

Figure 2.
Results of
structural model



of management more effortless. The [first hypothesis](#) stating that GS has a significant effect on the perceived success of the succession process is supported. An effective GS incorporating both family and business needs is essential for succession success. This study supports the previous study done by [Parada et al. \(2020\)](#) which emphasizes the growing need for understanding the governance mechanism as it has performance implications. It also emphasizes whether the structures are actually used or ceremonially used.

The [second research hypothesis](#) posits that GS has a significant effect on management succession planning is supported. This finding reiterates that a proper GS is inevitable in ensuring a proper management succession plan. Millennials and the Y generation, who are more used to the present-day administration strategies, give importance to a stronger GS. This GS constitutes both the aspect of the business and rules to be followed for a good management transfer. In the present scenario, most family businesses revolve around the advice of business consultants and analysts. The dependence of a GS is important since the vulnerability of the young educated successors is more considering their inexperience. Also, the questions related to morality and ethics are under the scanner. This situation galvanizes the importance of a GS for a smooth and proper management succession plan. The finding supports the previous study ([Arteaga and Menéndez-Requejo, 2017](#)), which found that good governance supports the succession system.

This study supports the [third hypothesis](#) that management succession planning has an important influence on the perceived success of the succession process. The findings empirically prove that a proper management succession plan is essential for the succession process's success. Usually, families where the business is their bread and butter talk and think about business even in their outings and gatherings. It can be considered part of their management succession plan, which they deliberately due to inculcate their tacit knowledge to their younger ones. As a part of a management succession plan, the firm grooms its successor's as per their requirements. It also aims to familiarize them with the working environment as well as the employees and working styles. During the training, the management informs the successors about the management transfer done in the previous generations. So a proper management succession plan helps transition the young successors to face new challenges and emerge successful in succession. The study's findings support the previous findings ([Christensen, 1953](#); [Brockhaus, 1994](#); [Lansberg, 1988](#)), which found that management succession planning has an important influence on the success and continuity of family business.

The [fourth hypothesis](#) in this study is also supported, which states that management succession planning mediates the succession process's GS and perceived success. This finding empirically proves that GS affects the perceived success of the succession process via the management succession planning in the Kerala context. GS covers all the aspects of the

business. It serves as a rule book for successful management succession planning without conflict, essential for any family firm to flourish. The written succession plan acts as a constitution for the next generation to follow and make it a dispute-free institution with a united stand in each step for a successful succession. Not many studies done on the mediating role of management succession planning on the GS and perceived success of the succession process, especially in Kerala, India. So the present study contributes to the limited number of literature available.

The size of the firm ($b = 0.28; p < 0.01$) and firm age ($b = 0.19, p = 0.02$) are significant predictors of the perceived success of the succession process is shown in Figure 3 and Figure 4. The family firm's size measures in terms of turnover. Most of the family businesses come in the category of 1–40 crore turnover. The majority of the family firms in Kerala come in the category of micro and small businesses since production-based industries are only a few. In terms of firms' age, most family businesses come in 30–90 years. Therefore the results are more applicable to family businesses managed in this category. Hence size and age of the family firms are controlled to some extent in the sample itself.

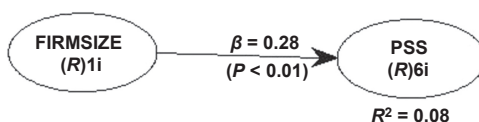


Figure 3.
Size of firm

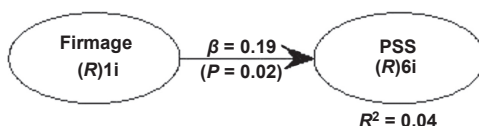


Figure 4.
Age of firm

6. Conclusion

This study explores the direct effect of GS on the perceived success of the succession process and, if so, whether management succession planning has any mediation effect. We develop a mediation research framework for testing the hypothesis of how GS affects the perceived success of the succession process through management succession planning. For testing the hypothesis, we use partial least square structural equation modeling (PLS-SEM). Using a sample of 113 family businesses in Kerala, we have demonstrated that the GS has a positive impact on management succession planning and that the management succession planning has a positive impact on the perceived success of the succession process. Further analysis reveals that management succession planning mediates the relationship between GS and the perceived success of the succession process. The study's findings are important for family businesses in Kerala, India, where many family businesses are still wondering what to do about adopting a family GS and planning for succession in their family businesses. This study provides evidence for the owners and successors to recognize the importance of implementing an effective GS and management succession planning for the success of the succession process. The results of the mediation model of this study also confirm and provide the suggestion that GS has to be supported by an effective management succession plan to achieve the success of the succession process.

6.1 Implications for managerial practice

The findings give an insight to various researchers, family business consultants and different family business stakeholders about various aspects of GS and management succession

planning and how to manage it effectively for the successful generational transition. Management succession planning and implementing a good GS are the most crucial aspect of the family business. Even though owners have also recognized the importance of management succession planning, they seldom plan for it. Owners usually are assigned with the tasks of preparing the succession plans and implementing a good GS. They have to ensure that talented, well-trained successors must be there to uplift the firm to the next growth stage. Good GSs act as best practices for the succeeding generation to follow.

6.2 Limitations and future research

The main drawback of this study is the small sample size. In future empirical studies, more samples to be incorporated from different types of family businesses. As a comprehensive database on family businesses in the Kerala context is not available, the snowball sampling technique is adopted and cannot ensure the sample's representativeness. We cannot rule out self-selection bias since the snowball sampling technique is adopted. This study relied mainly on the respondent's perception. There is a chance of bias as it is a subjective-based study, and no objective measures were taken to measure the variables, especially the success of the succession process. Future studies can incorporate both subjective as well as objective measures to measure variables. As this study confines to Kerala, India context, it is not possible to generalize the study results as there is a chance of cultural biases of the respondents. The results of this study cannot be generalized to other countries, especially western countries where there is a difference in culture.

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