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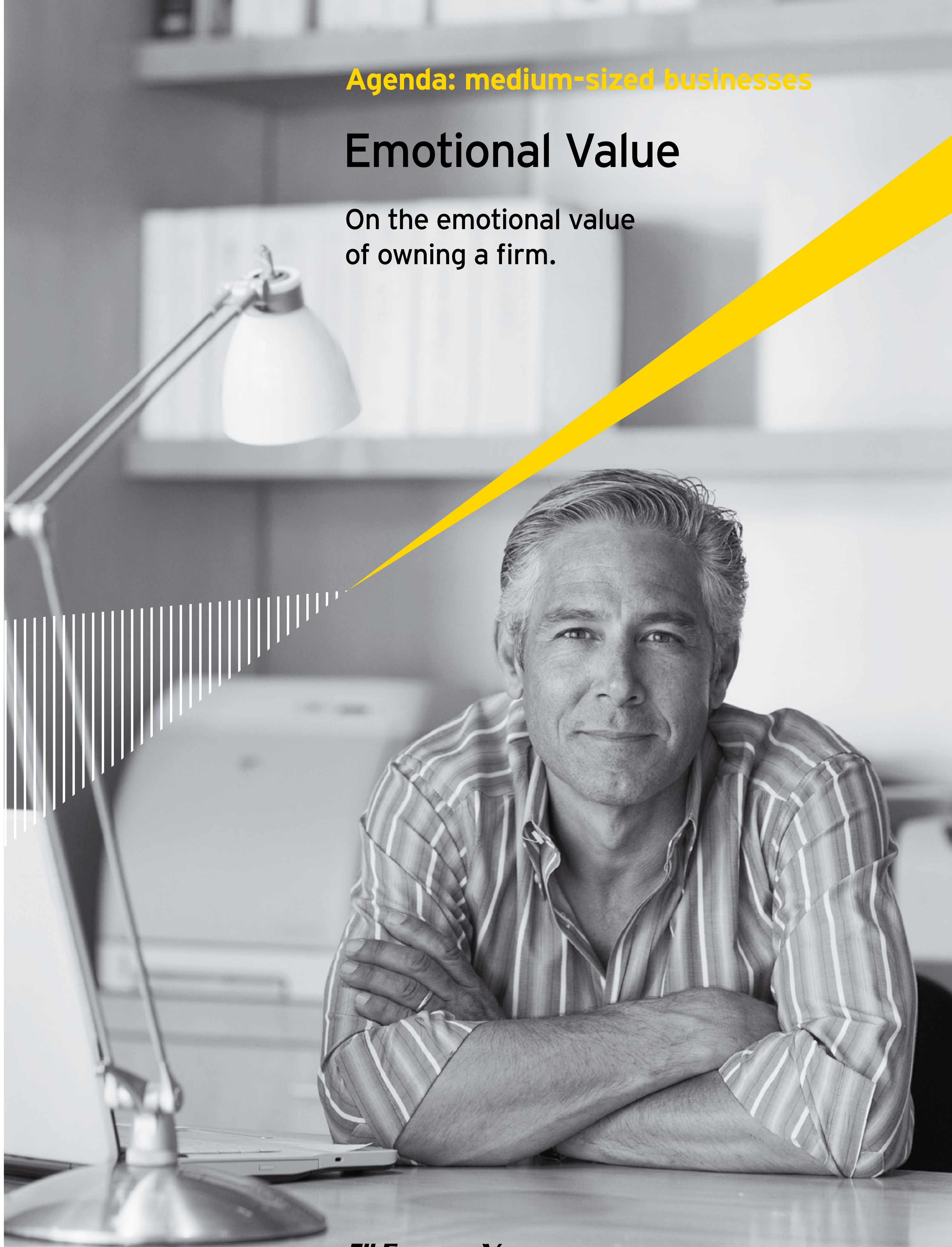

Agenda: medium-sized businesses

Emotional Value

On the emotional value of owning a firm.

Ernst & Young
Quality In Everything We Do

In cooperation with:

Center for Family Business
University of St.Gallen

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[1] Although, for the sake of readability, we have used the male formulation in the study, the female formulation shall be understood as equally encompassed.

Foreword

This study examines the question of how emotional aspects are to be valued in the context of firm ownership. It offers a profound insight into the psychology of firm owners,[1] for whom not only financial values but also emotional aspects play an important role. In our study, we analyze the key influencing factors and attempt to quantify the emotional components.

At this juncture, we would like to offer our special thanks to the firm owners who took the time to furnish the data and information we required. This study is dedicated to them.

We hope you will find the study an interesting read.

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Finding a business successor – what really matters?

Finding a suitable business successor is a unique challenge in the life of any owner-manager. He must find a workable solution that will allow his life's work with all its ties and connections to pass into what will be a new future.

Securing a business successor is, therefore, one of the most important strategic responsibilities of corporate management.

It will shape the future of both the firm itself and of the family running it.

According to the Institut für Mittelstandsforschung (IfM – German Institute for Research in Medium-Sized Enterprises), more than 70,000 owner-managers in Germany attempt to find a successor for their businesses each year.

Of these firms, around 44 percent will be passed on to family members, 27 percent will end up in the hands of employees (management buy-out) or external executive managers (management buy-in), and 21 percent will be sold to third parties. As many as 8 percent will have to close for want of a suitable successor. Each year, 33,500 jobs are lost for this reason alone. Successful business succession is, therefore, also extremely important for the economy as a whole.

Business succession is a complex process. Different issues – e.g. legal, fiscal, financial and personal aspects – and perspectives – e.g. of the owner-manager himself, the family, the successor and the staff – must be considered and harmonized if the process as a whole is to succeed. The fact that ideas and expectations in connection with this process often diverge strongly merely reflects the inherent risks. And the process risks increase immeasurably if preparations are started too late.

The driving interests of the owner-manager in the context of business succession are usually safeguarding the long-term position of the firm so that his life's work will be perpetuated and jobs in the firm protected, securing his own financial position and that of his family, finding a fair solution to issues of inheritance, and, last but not least, maximizing the selling price of his firm. The successor, especially if he is not a family member, will want to see how viable, sustainable and robust the firm is, and take a close look at the concomitant operative and financial risks. And then there's the small matter of price. Firms basically have the following options when it comes to finding a business successor:

- The firm is taken over by a family member (who takes up appropriate shares in the firm)
- The firm is taken over by firm employees (management buy-out)
- The firm is sold to another manager (management buy-in)
- The firm is sold to a holding company
- The firm is sold to a strategic buyer or competitor

At the preparation stage, the owner-manager will need to ascertain which of these alternatives is/are an option. The following factors play a decisive role in the successful planning and execution of a successor solution.

Timing is all-important
Defining and implementing the right solution requires adequate lead time.

The precise date on which succession takes place depends, therefore, on the individual situation of the firm, the personal situation and drive of the owner-manager himself, and – if the successor is from among the ranks of the firm or the family – the personal situation of the successor. The earlier the outgoing owner-manager tackles the issue of succession, the more scope he will have in which to plan and implement a solution. Ultimately, this is also important because, as experience shows, not all the intended solutions go according to plan.

Sort out the asset and financing situation
Many family-owned businesses invest most of their assets in their own firm. Frequently, personal and business financial arrangements are heavily interwoven. These patterns need to be identified and entangled in good time. If the successor is a family member, entitlements under marital property regimes or claims for legal portions made by other descendants will often have to be considered.

Make the firm fit for succession
A firm's financial situation and, in particular, its profitability and growth opportunities are key factors driving the interest of prospective buyers and successors. The organizational and operational autonomy and dependence of the owner-manager are others. Thus, establishing a second management and operational level in good time that is capable, among other things, of securing the transfer of know-how from the owner-manager into the organization is just as important as is building clear internal organizational structures and creating a workable and transparent reporting system.

Establish notional values of the firm's worth, taking emotional aspects into account
Many owner-managers live for their firm. Very often, they will have battled for decades in the interest of their firm, committing a great deal of time, effort and emotion to the cause. Moreover, they will have invested a lot of money in the firm. Yet while aspects like these certainly shape the owner-manager's notion of his firm's value, they will be more difficult to appreciate, if indeed at all, by a third party, who must base his valuation solely on economic and operational facts. In the preparation stage, therefore, owner-managers will need to acquaint themselves with prospective third-party valuations and build these into their decision-making process. During preparation and execution of the succession solution, it is advisable to request the services of firm valuation and transaction specialists who will be able to provide the necessary know-how and mediate between the individual parties.

Optimize legal and fiscal matters
It is essential that the succession plan takes adequate account of all legal and fiscal matters. The following issues need to be clarified, for example: is the firm's current legal form practical – and indeed tax-optimized – in view of the forthcoming transfer? What is the current situation concerning the inheritance of firm assets in the case of death? Here too, we recommend that professional support is obtained in order to avoid disputes, unpleasant surprises and stumbling blocks along the road to business succession.

As a long-standing advisor to medium-sized businesses, Ernst & Young can help you secure your life's work, provide answers to tricky questions, and successfully organize a successor solution for your firm.

Whether it involves a change of family generation, a management buy-out or buy-in (MBO or MBI), or the sale of the firm or parts of it to a third party, our advisors will provide you with all the support you need in the form of a tailored succession plan. We will work out individual solutions with you. We offer a comprehensive project management service, from strategy development and structuring, to closing the deal. In short, we will help you make the right entrepreneurial decision.

Hanno Hepke
Partner
Ernst & Young Corporate Finance
Beratung GmbH

Contents

"We obtain benefit not only from material objects that are to be exchanged, but also from natural values, from the joys of the spirit and the heart; these things too possess the ability to satisfy our desires on a higher level and should therefore be seen as useful and valuable as well."
Jules Dupuit (1853)

"The diversity in our opinions does not spring from some of us being more able to reason than others, but only from our conducting our thoughts along different lines and not examining the same things."

René Descartes (1637)

"The sadness we feel when we lose a person or cherished object is a reflection of the value that person or object had for us. (...) We must understand emotions as an expression of values. And if they are indeed that, we must not regard emotions as the enemy of a cool cost-benefit analysis, but as part of it."
Martha Nussbaum (2001)

"There's a prospective buyer for my firm who's prepared to pay me the valuation price of 20 million euros. To be honest with you, I'd sell it to him for 15 million.
As the founder, owner and CEO of my firm, I've carried a whole lot of responsibility on my shoulders for years; I've burnt myself out mentally and physically and I've neglected my family in the process. Enough's enough! That's why I'd be prepared let the firm go for less."
An owner-manager featured in our study (2008)

Introduction

The introductory quotes show that it is not always just material values that count when we try to place a value on an object, but very often emotions and feelings too. This finding is particularly relevant to firm owners, whose decision to own a business is often not based on financial considerations alone. Positive aspects such as entrepreneurial freedom, social status and challenge, alongside negative factors like stress, isolation and responsibility play a greater role in the overall valuation process. That said, valuation methods centered on financial and economic indicators completely overlook these emotional components.

The aim of this study is to examine how owners of firms subjectively value their ownership stake in emotional terms.
To this end, we asked various owner-managers how much they would be willing to sell their firms for. As stated in the introduction, we expect emotional aspects to play a significant role alongside financial considerations. Thus, the price at which owners are prepared to sell their firms has two components: the financial value and the emotional or non-financial value. This study enhances our understanding of the origins of a firm's "emotional value" for the respective owner. It helps firm owners to analyze their own situation as a basis for scrutinizing the price they are asking for their firm. Prospective buyers also stand to gain from the study as they will be able to better understand the seller's negotiating position and propose pertinent alternatives. Further, we have developed a rudimentary method of calculating the emotional value as a means of quantifying the phenomena described and applying them in everyday practice. By and large, the study will provide us with a more complete picture of what it means to own a firm.

Structure of the study
We will start by summarizing theoretical foundations, definitions and concepts and explaining the underlying random survey and the methods used. We will then formulate our expectations as to the origins of emotional value and discuss the respective findings. In addition, by way of a further expansion of our considerations, we will attempt to put an approximate figure on emotional value. After discussing the pros and cons of a positive emotional value, we will conclude the study by presenting several insights of high relevance to the various stakeholder groups.

1. Theoretical foundations

Essentially, this study is based on two theoretical foundations, namely the *Endowment Theory* and the *Possession Attachment Theory*. These theories are presented briefly in the following. How they are specifically applied in the context of this study is described in the next chapter.

1.1 Endowment Theory
This theory is derived, among other things, from the deliberations of Thaler (1980) and Kahneman, Knetsch and Thaler (1991). The central element is what is known as the "endowment effect". Theory finds that assets that are part of an individual's endowment (ownership) are valued more highly than assets that are not included in the individual's present endowment. It therefore follows that people will demand a higher selling price for a good they own than the price they would be willing to pay for the same item if they did not own it and had to purchase it. Thus: *"I'm willing to sell my house for not less than a million Euros. But if I were to buy the house myself on the market, I wouldn't be prepared to pay more than 700,000 Euros for it."* This is because the seller is taking into account the potential (emotional) loss they would suffer by selling the good. This effect occurs when an individual feels attached to an object. This concept is closely related to the Possession Attachment Theory described in the following, and is indeed seen as an extension of the latter (Ariely, Huber & Wertenbroch, 2005). The endowment effect is more or less a consequence of attachment to a possession.

1.2 Possession Attachment Theory
Possession attachment theory describes the relationship between an individual and a specific material object that has been psychologically appropriated, decommodified, and singularized through person-object interaction (Schultz-Kleine & Menzel-Baker, 2004). Also, owners often regard possessions as part of themselves, as part of their own identity (Belk, 1988). As a result, owners define themselves to a certain degree by what they possess. To a large extent, then, *"we are what we have"*. This theory allows us to deduce which aspects (e.g. the age of the person, the type of good, the length of ownership) lead to an emotional bond and in what way.

2. Definitions and concepts

The two theoretical foundations introduced above have a similar effect on the anticipated selling price. Thus the strength of the attachment between the owner and the object may be indicated by behavioral tendencies such as a willingness to sell possessions only above or at market value (Belk, 1991). Even an exact reproduction of the endowed object will be deemed an unsatisfactory replacement for the original, which will be regarded as unique, especially if it has been used intensively or the person-object interaction has been particularly strong.

The endowment effect also results in the seller and the buyer being unable to agree a price for the object in question. The underlying terms here are "willingness to accept" (WTA) and "willingness to pay" (WTP). WTA (Knetsch & Sinden, 1984) is the minimum price the owner is willing to accept for his object, while WTP is the maximum price the prospective buyer is prepared to pay. Research shows that WTA and WTP often diverge considerably for one and the same object (Carmon & Ariely, 2000). This highlights the link between these concepts and the aim of the study. The minimum selling price in the eyes of the owner and the maximum price the prospective buyer is prepared to pay frequently diverge greatly due to the attachment and endowment effects that are present exclusively in the selling party.

It therefore follows that the minimum acceptable selling price for the owner consists of an "objective" price deduced on the basis of conventional methods of valuation, and also an emotional component. The latter is the emotional value which, in the context of our study, is attached to a firm (cf. Zellweger & Astrachan, 2008).

When added to the financial value, this phenomenon produces what is known as the "total value". This is the seller's "willingness to accept" (WTA), i.e. his minimum acceptable selling price. The buyer's "willingness to purchase" (WTP) is considered as the same as the financial value. The emotional value can thus be defined as follows:

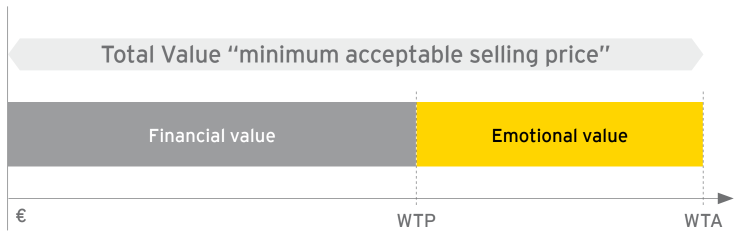
Total Value (WTA) = Emotional Value + Financial Value (WTP)

or

Emotional Value = Total Value (WTA) – Financial Value (WTP)

Research shows that with owner-managers, the emotional value can be significantly above the financial value (Zellweger & Fueglistaller, 2006). However, this study does not aim to focus solely on measuring the emotional value. We want to try to show which emotional aspects affect the minimum acceptable selling price. The following graphic (Fig. 1) shows the correlations between the concepts we have introduced.

Overview of value concepts used
Figure 1



To make things easier to understand, in the further course of the study, the term "minimum acceptable selling price" will be used synonymously for the terms "total value" and "WTA".

3. Random survey and method used

The study is founded on responses to questions received from 349 firms. In spring 2008 the authors contacted owner-managers throughout Germany using two randomly compiled address-data sets. Between April and July 2008 the firms returned their answers to the Center for Family Business at the University of St. Gallen. Below is a brief summary of the main characteristics of the firms and their owner-managers.

The average age of the owner-managers was 52. More than 40 percent of them had a university degree and almost 90 percent were male. They were working a 56-hour week and paying themselves a salary of, on average, EUR 170,000 p.a. The average age of the firms was 56. Almost 44 percent of the firms were operating in the manufacturing sector and industry, a further 22 percent in the services sector, while the remainder were active in other areas such as the building trade or the health sector. The firms were owned by, on average, 4.49 managers. The average equity ratio of the firms was 33.89 percent. Of this, 66.82 percent was owned personally by the owner-manager contacted (88.73 percent if we include other members of his family). Almost 90 percent of the owners regarded their firm as a family firm.

The firms that took part in the random survey employed a staff of 506, on average. In addition, 2.49 family members on average held positions within the firm. The average revenue generated by the firms was EUR 92.1 million, with an average operating cashflow of EUR 7.6 million. The average return on equity was 27.87 percent. The table below (Table 1) gives an overview of the mean values, medians and standard deviations of most of the key figures used.

Kennzahlen der Stichprobe

Table 1

	Mean value	Median
Age of the firm in years	56.20	45.00
Number of employees	506.44	90.00
Annual revenue in EUR	92.1 million	11 million
Number of shareholders / owners	4.49	2.00
Equity ratio in percent	33.89	30.50
Share of equity capital owned by family in percent	88.73	100.00
Share of equity capital owned personally by the owner-manager in percent	66.82	70.00
Return on equity in percent	27.87	20.00
Operating cashflow in EUR	7.6 million.	800,000
Age of the owner-manager in years	52.56	53.00
Number of active family members (all positions)	2.49	2.00

So the average owner-manager is around 52, male, relatively well-educated, works a lot of hours but earns well, and possesses around two thirds of the firm's equity capital. The "average firm" was founded in the post-war period, is in its second generation of family ownership, is relatively large (500 employees), is regarded as a family firm, and boasts healthy performance figures. As part of our survey, we posed the following question to the firms in order to generate data on the minimum acceptable selling price to a third party (i.e. a non-family member): *"What is the minimum acceptable selling price at which you are willing to sell 100 % of your firm's equity to a non-family member?"* By formulating the question in this way, we ensured that, in selling their firm, the owner-managers considered the value of the equity (not the value of the overall capital), that they considered the whole of the equity and not just their own share, and that the firm would be sold to a non-family member.

We also defined a set of control variables that would allow all financial aspects that might affect the acceptable selling price to be factored into the equation. This ensured that we would entertain the notion of an emotional influence on the acceptable selling price only once all financial aspects had been excluded. Then, in three mathematical models, we looked at various independent determining factors that might explain what an acceptable selling price is. For this purpose, we used a statistical program (SPSS) and ran several stepwise linear regressions. More detailed information on variables, models and significance values can be found in the appendix. For more detailed analyses, we used sub-samples, comparisons of mean values and/or medians, and other calculations.

4. Overview: factors which influence the minimum acceptable selling price

In the following section, we have formulated several emotional factors based on our theoretical foundations which are expected to influence the minimum acceptable selling price to a third party (a non-family member). In doing so, we have taken account of the three time phases experienced by every owner-manager:

1. Phase of acquiring ownership
"How did I obtain my share in the firm?" We scrutinize, in particular, the scenario where the owner is also the founder. We also examine the role played by family tradition and feelings of obligation to join the firm.

2. Phase of ownership
"What has been my experience of owning the firm?" Here, we look at aspects such as physical and mental strain, the level of conflict within the family, and the length of time the firm has been in family ownership.

3. Phase of potential sale
"When I think of selling the firm in the future, what are my expectations?" A major distinction here is whether the prospective buyer is a family member or not. Figure 2 summarizes the expectations discussed in more detail in the following passages.

Expectations with regard to the factors influencing the minimum acceptable selling price
Figure 2

Phase 1	Phase 2	Phase 3
How share/ownership of firm came about:	Experience of ownership:	Deliberations concerning a prospective buyer:
▸ Founding owner/non-founding owner ▸ Joined firm through feelings of obligation to follow family tradition	▸ Physical and mental strain ▸ Conflicts within the family ▸ Length of time the firm has been in the family	▸ Family member or third party

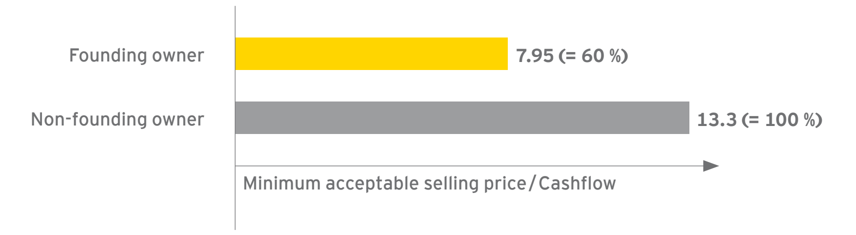
5. Expectations and discussion of individual findings

In this chapter, we expand on the expectations introduced briefly beforehand. We also examine the individual findings of the study. Will our expectations be confirmed or rejected?

Phase 1: How ownership of the firm came about

1. The owner-manager is also the founder of the firm
Firm ownership may have come about in a number of different ways, e.g. through foundation, acquisition or inheritance. Where the owner is the founder, it can be assumed that he has invested a lot of time, money and energy in building up the firm, especially in the early stages of its existence. He will know the firm inside out, having had a direct influence throughout the entire course of its history. The firm is his life's work; it is a part of him, part of his identity (cf. Belk, 1988). For this reason, a very strong emotional attachment will exist between the founding owner and his firm. Taking the effects discussed in theoretical part into account, one would expect the minimum acceptable selling price to be higher if the firm was founded by the owner-manager selling it.

Mean values of the multiples of founding owners and non-founding owners
Figure 3



Finding: founding owners sell cheaper than non-founding owners.
Whether or not the owner-manager actually founded the firm has a significant effect on the minimum acceptable selling price. Surprisingly, however, the correlation is negative, i.e. the asking price actually falls if the owner is the firm founder. So a founding owner is content with less than a non-founding owner. The fact that a seller inherited his firm does not have any significant effect. In order to represent the difference in the minimum acceptable selling price, we use a "multiple". Generally, multiples are factors with which certain profit figures are multiplied in order to calculate a firm's value. In this case, we divide the minimum acceptable selling price to a third party (i.e. a non-family member) by the cashflow for the group of founders and for the group of non-founders. So rather than analyzing absolute amounts or figures, we look at how the two figures correlate. This procedure increases our options for interpreting the data because it allows us to derive independent results from the absolute amount of the cashflow (and thus the size of the firm). Having said that, we need to exercise care when interpreting the correlation because it is not only the type of the owner which influences matters. Notwithstanding these restrictions, the analysis shows that founding owners are prepared to sell their firm for, on average, around 40 percent less than non-founding owners (see Fig. 3).

So why are founding owners prepared to sell their firms for less? One reason could be the stress-and-strain factor. As we have already said, it can be assumed that a founding owner will have invested a great deal of time, money and energy in building up the firm, with considerable personal risk and responsibility, especially in the early years. Clearly, compensation for this investment is not an overriding issue in this scenario. It emerged that founding owners often simply want to "opt out" due to the years of stress they have suffered and the time and effort they have invested in the firm; and they are even prepared to accept a lower selling price to do so. The wish to rid themselves of the strain more than offsets any compensatory desires. Furthermore, a subsequent analysis also showed that the founding owners in our random survey were subject to significantly higher physical and mental strain than non-founding owners.

2. The significance of following in the family tradition
Especially in older family firms, perpetuating the family or business tradition often has top priority and is a key factor. Potential family members often feel obliged to actually take on the job. An owner who entered the firm on these terms and who is expected to maintain family traditions in the future will find it very difficult to sell to a third party. Moreover, a positive link has been found to exist between the desire to pass on ownership of the firm to future family generations (kin-keeping) and emotional value (Zellweger, Kellermanns, Chrisman & Chua, 2008). We will assume, therefore, that this type of owner will only consider selling to a third party if an extremely good price is in the offing as compensation for forfeiting the family / business tradition. So the greater the significance attached to family / business tradition and the perceived obligation to carry it on, the higher the minimum acceptable selling price will be.
Finding: the more important the notion of carrying on family tradition was when the owner entered the firm, the higher the selling price will be.
For the purpose of our study, the significance attached to family tradition, the option of perpetuating that tradition, and the perceived obligation to enter the family firm, were all summarized in a single factor. This factor has a significantly positive effect on the minimum acceptable selling price. This confirms our expectations categorically.

Phase 2: Experience of ownership

1. Mental and physical strain
Research shows that ownership can also bring serious disadvantages to the owner-manager. These include manifold personal sacrifices, the burden of responsibility, risk exposure, long working hours and the often resulting dominance of professional life, not to mention the resulting stress and isolation (Douglas & Shepherd, 2000; Tetrick, Slack, Sinclair & Da Silva 2000). If the mental and physical strain becomes extreme, we would expect the owner to want to do something about the situation. He is therefore prepared to accept a lower selling price because getting rid of the stress and strain is of greater priority for him. We assume, therefore, that the greater the mental and physical strain, the lower the minimum acceptable selling price will be.

Finding: Mental and physical strain leads to lower selling prices.
Our evaluations reveal a significant negative relationship between mental and physical strain and the minimum acceptable selling price. A significant negative correlation even exists between the amount of equity owned personally by the owner-manager and the minimum acceptable selling price, which can be an indicator of strain. Our expectations are, therefore, borne out. This is a token of the strong desire on the part of physically and mentally burnt out owner-managers to rid themselves of the job-related strain. This outweighs any thoughts of compensation for the sacrifices made. Thus, the much-hoped-for reduction in stress and strain in the future is more important than any compensation considerations for the effort they have put into the business in the past. This corresponds to the above-mentioned argument concerning the selling prices asked by heavily burdened founding owners.

2. Level of conflict within the family
Family firms are characterized by an identity overlap between the family / firm social systems (Habbershon, Williams & MacMillan, 2003). The resulting merging of family and business affairs in family firms means that they are often particularly susceptible to misunderstandings and conflicts (Sharma, 2004). These can involve tasks, processes and interpersonal relationships (Jehn, 1997; Kellermanns & Eddleston, 2004).

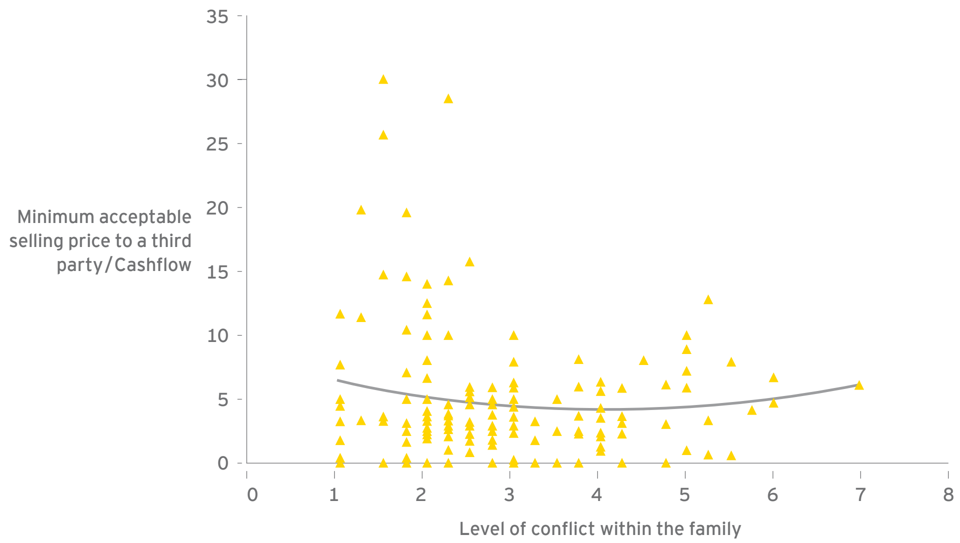
We would expect the level of conflict within the firm to have a negative effect on the minimum acceptable selling price. Conflicts distract the owner from his real work and also result in extra mental strain. The owner is therefore prepared to sell for a lower price just to rid himself of the conflicts and the related stress and friction.

Finding: there is a u-shaped correlation between family conflicts and selling prices.
An analysis of the relevant factors shows that the level of conflict has both negative and positive effects on the minimum acceptable selling price. With reference to the multiples introduced earlier, these effects can be represented in the form of a u-shaped curve. Initially, in line with our assumption, the minimum acceptable selling price falls in line with the level of conflict. But then it begins to rise again. There is, therefore, a trough, a low-point at which the mindset of the potential seller begins to change. Thus, if the level of conflict continues to rise, the seller will increasingly desire compensation for the effort and sacrifice he has invested in trying to overcome the conflict in his firm (known as sunk-cost considerations), a phenomenon which tends to push the minimum acceptable selling price up again. In other words, he doesn't want to have battled for nothing (see Fig. 4).

3. Duration of ownership
As we discussed in theoretical foundations, the relationship between an individual and an endowed object arises through repeated person-object interaction, the object becoming psychologically appropriated and singularized (Schultz-Kleine & Menzel-Baker, 2004). From the owning family's point of view, the number of generations the firm has been in the family is a crucial factor. Duration of ownership has a direct effect on the strength of the ties between the family and its firm. We would expect that the current owner, as representative of the family, would be prepared to cut these strong ties only in exchange for appropriate financial compensation. Thus, the longer the duration of ownership measured in terms of family generations, the higher the minimum acceptable selling price.

Finding: the longer the firm has been in the family, the more expensive the selling price.
Thus, a significant positive correlation exists between the number of generations the firm has been in the family and the minimum acceptable selling price. Our expectations are, therefore, clearly borne out. Family ownership stretching back decades or even centuries has a decisive effect on the ties between the family and its business. Severing these ties would be conceivable only if appropriate financial compensation were offered.

Cashflow multiple versus level of conflict within the family
Figure 4



Phase 3: The influence of the type of prospective buyer

We would also expect the type of the prospective buyer to have an effect on the minimum acceptable selling price. When family members are in the frame, there are basically two options: The founding owner can sell to a family member(s) or to a third party. In the former case, important family and firm traditions are safeguarded. And a certain degree of influence can be maintained. Altruism can also play a part when family members are involved. Family bonds mean that a senior who is in the process of withdrawing from the firm will not normally be interested in complicating the entry of a successor into the firm by demanding too high a price.

For these reasons, our expectation is that the minimum acceptable selling price will be much lower in the case of a sale to a family member than it would were a non-family member involved.

Finding: owners sell much cheaper to family members.

Whether the buyer is a family member or a third party really does play a crucial role. The values given for the minimum acceptable selling price in the case of a sale to a family member amount to only 78 percent of the value of a sale to a third party. In other words, an owner-manager who asks EUR 1 million for his firm when selling to someone from outside the family will be satisfied with EUR 780,000 when selling to a family member (see Fig. 5). Here, we initially use the absolute amounts given in all those cases where minimum acceptable selling prices were specified for both types of buyer.

The type of third-party buyer is of no significance to the selling price. Whether the firm, for example, is to be sold to another family firm or to a private equity investor has, according to our study, no significant effect on the minimum acceptable selling price. So the desire to keep the firm in the family plays an important role. The owner is evidently willing to dispense with the extra cash he would have been able to earn by selling to a third party. It is worthwhile taking a closer look at how these two prices are distributed. To do so, we need to examine two multiples again:

Sale to family member(s) versus sale to third party (mean values)

Figure 5

[2] The difference between the two values is 32 percent. The difference to the 22 percent stated above is partly explained by the fact that cashflow values are not available for all the cases used. As such, the random surveys are not fully congruent.

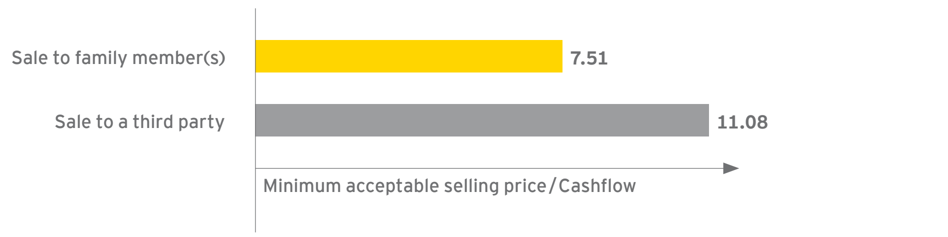
The first is defined as the minimum acceptable selling price to a family member(s) divided by cashflow; the second has already been introduced and is the minimum acceptable selling price to a third party divided by cashflow. The mean value of the first multiple is 7.51, that of the second 11.08[2] (Fig. 6).

It is worthwhile showing the distribution of asking prices in relation to the respective cashflow in the form of a graph (Fig. 7).

On the bisecting line (selling price to third party = selling price to family) are all those owner-managers whose asking price did not distinguish between sale to a family member and sale to an external bidder (25.2 percent of all cases). Above this line are the owners who granted a price discount to family members (67.4 percent). The further these points ascend above the bisecting line, the higher the discount granted to family members. Below the line are those owners who would be prepared to sell cheaper to a third party than to a family member. There were, however, no such cases in our random survey. The points located directly on the vertical axis are the owners who would be prepared to give their firm away to a family member for nothing (7.4 percent). Our survey contained 16 examples of such altruism. No one, however, would be willing to give their firm away free of charge to a third party. Generally therefore, quite a number of owners draw no distinction between a sale to a family member and a sale to an external buyer. By far the majority of owners are, however, prepared to sell cheaper to a family member. This distribution is illustrated in Figure 8.

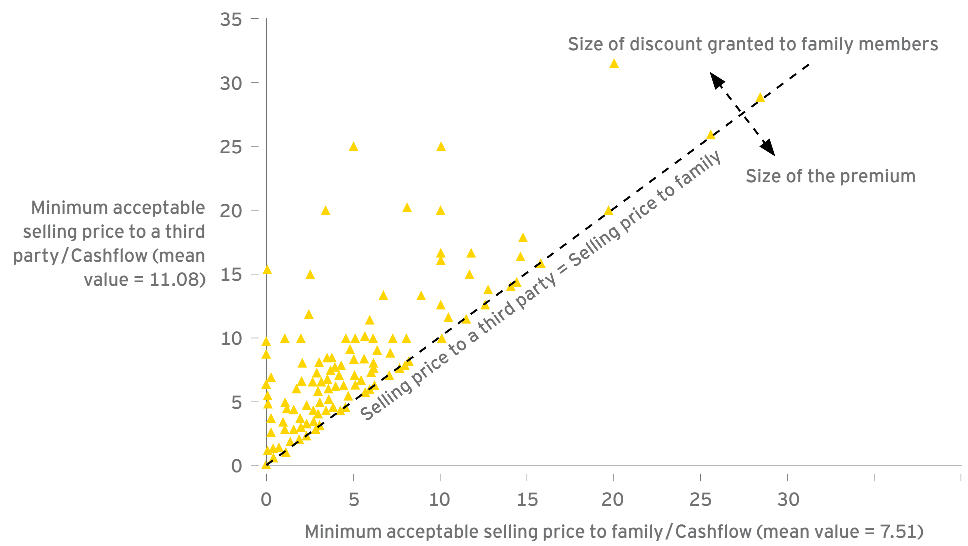
Mean values of the cashflow multiples in the case of sale to family member(s) and sale to a third party

Figure 6



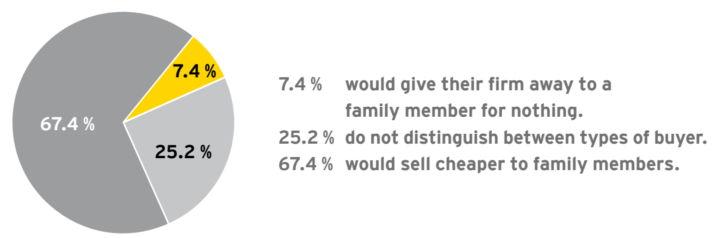
Multiple family versus multiple third party

Figure 7



Seller's asking price depending on type of buyer

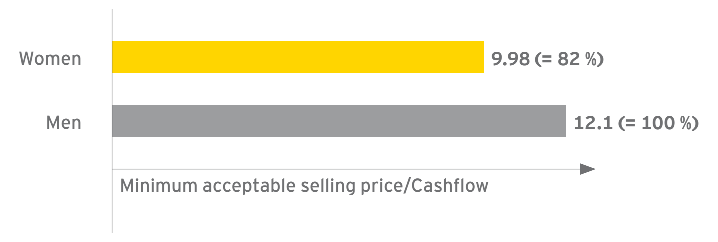
Figure 8



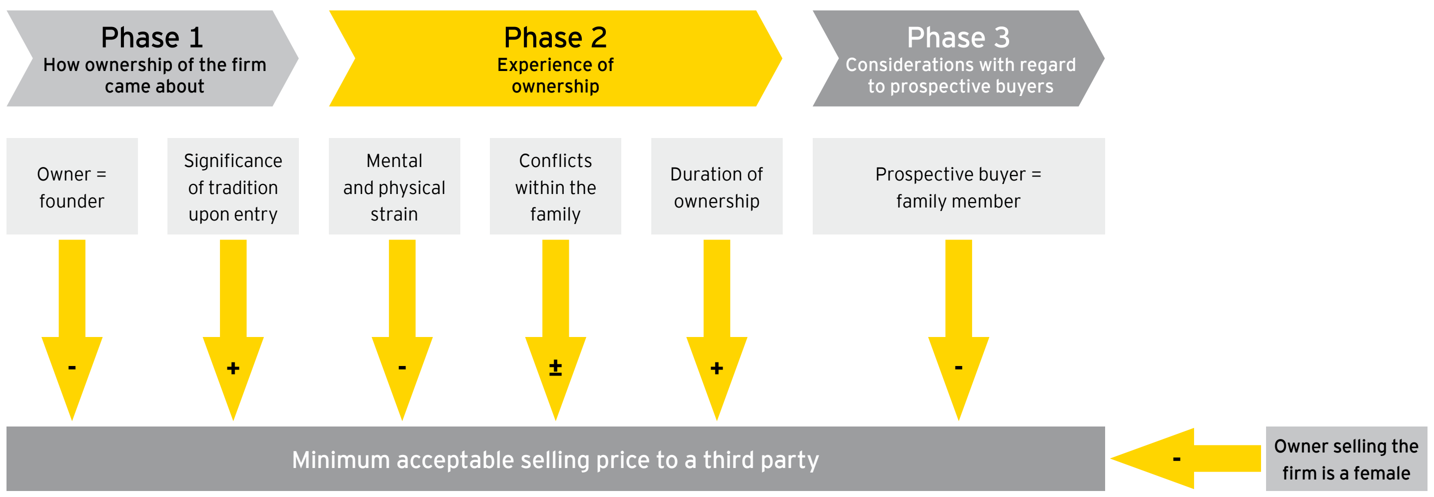
General findings and considerations

Finding: women ask less for their firms than men.
Although not explicitly worded, we examined whether the gender of the seller affected the minimum acceptable selling price. The results are convincing. Female owners were willing to sell 100 percent of the equity capital for less than male owners. To illustrate this phenomenon, we again use the mean values of the multiples for men and women introduced earlier. Thus, the selling price asked by women is around 18 percent lower than that of men, although this can be partly explained by other factors (Figure 9).

Mean values of the multiples of men and women
Figure 9



Results for the minimum acceptable selling price
Figure 10



One explanation could be differences in attitudes concerning the ownership of material possessions that exist between the genders, as described in possession-attachment literature (Schultz-Kleine & Menzel-Baker, 2004). The way in which an endowed object can be used evidently plays a role (cf. Zellweger & Astrachan 2008). Studies on gender-specific possession attachment have shown that women display attachment to possessions for the social connections embodied in or "enabled" by them. Men, by contrast, find it easier to establish emotional connections to objects which embody material values (Schultz-Kleine & Menzel-Baker, 2004). If we accept that firm ownership first and foremost represents material value, we may assume that women attach less importance to this kind of ownership. The age of the person selling the firm does not play a significant role in the analysis. The following illustration (Figure 10) summarizes all the influencing factors discussed and their effects.

Learning from extreme cases: "I will give my firm away to a family member for nothing."
In order to obtain further insight into the meaning of emotional value, we wanted to take a closer look at the group of owners in the survey who were prepared to give their firm away to a family member for free ("donors"). Our survey contained 16 owners who were prepared to do just this. What specific characteristics do they display? We contrasted the group of "donors" with a similarly sized group of owners who were prepared to sell their firms to family members only for a very high asking price. We constructed the latter category by taking the 16 owner-managers who displayed the highest quotients of "minimum acceptable selling price to a family member" and cashflow. The table below (Table 2) shows the mean values of the relevant indicators for the two groups compared. The differences between the individual mean values are significant in every case (five percent level).

The analysis showed that the "donors" were almost ten years older than those owners whose asking prices were the highest for a sale to a family member. Moreover, donors were found to have more work pressure, enjoy greater support from the family, hold a greater percentage of the firm's equity, and be firm founders.

Donors versus sellers with high asking prices
Table 2

	Give firm away to family member(s) for free mean value	Sellers with the highest asking prices for family member(s) mean value
Selling price / Cashflow	0	38.7
Age of the owner-manager in years	57.1	48.1
Work pressure (on a scale of 1-7; 1 = low, 7 = high)	6.3	5.4
Support from family (on a scale of 1-7; 1 = low, 7 = high)	5.7	4.8
Percentage of equity capital owned personally	83.6	57.9
Seller = Founder (1 = yes, 0 = no)	0.5	0.1
Firm's return on equity in percent	26.9	12.0

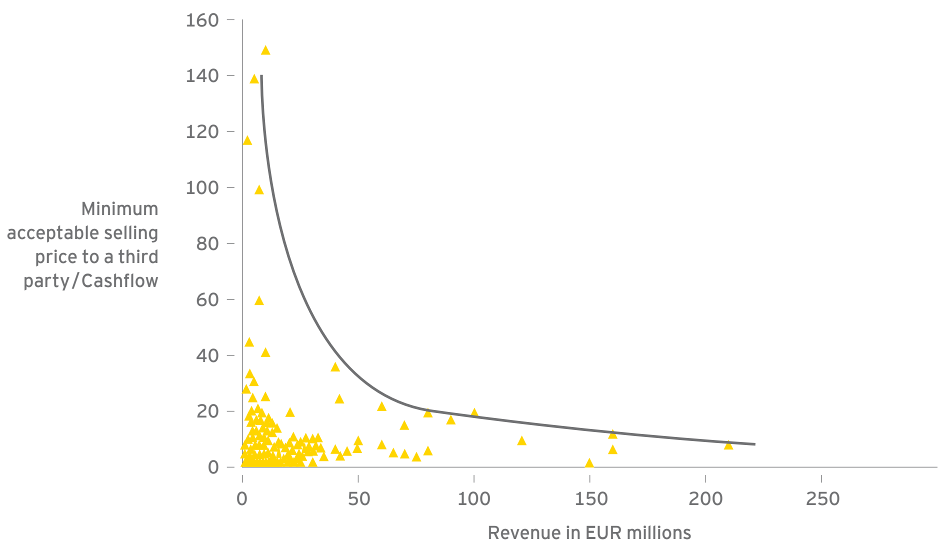
The firms being passed on for free display a higher return on equity than those being sold at a premium. It is not the case, therefore, that largely financially unattractive firms are given away, as one might assume. On the contrary, it seems to be the case that owners are prepared to pass on their firms for free when they are approaching the end of a professional career which has seen them establish a firm that is now in a sound and healthy financial position. However, these owners experience a great deal of stress in their work and, on account of the higher equity stake, carry much greater responsibility than the owners who sell at a very high price. At the same time, these entrepreneurs enjoy a good deal of support from their families.

Size as an influencing factor
We also contrasted the multiple for selling to a third party (the minimum acceptable selling price to a third party divided by cashflow) with the generated revenues in order to take account of any effect caused by firm size (Figure 11).

Indeed, the distribution shows that the upward swing of the multiple became much less pronounced as firm revenues increased. In other words, the multiple rises more profoundly and more frequently the lower the revenue figure. The factors in our study identified as affecting emotional value appear to play a lesser role as the size of the firm increases. Thus, the significance of the emotional value diminishes the bigger the firm gets. Evidently, the owners of larger firms pay greater heed to financial realities, leaving aside the emotional factors.

Multiple third party versus revenue

Figure 11



The owners of larger firms pay greater heed to financial realities, leaving aside the emotional factors.

6. Putting a figure on the emotional value

If we are to gain even an approximate idea of the significance of the "emotional factor" in the firms surveyed, we need to establish a benchmark value. The following relationship, which we have already presented, serves as a starting point:

Minimum acceptable selling price = Financial Value + Emotional Value

or

Emotional Value = Minimum acceptable selling price – Financial Value

Here, we refer to the minimum acceptable selling price to a third party, the value of which we have obtained from the completed questionnaires. The financial values of the firms in our random test are approximations. We should point out that our benchmark makes certain assumptions that prevent it from being an absolutely reliable indicator of a firm's financial value in every case.[5] If it is to be applied to individual cases, the specific features need to be taken into account. In the following, we understand the financial value (the value of the equity capital) to be the quotient of the cashflow and the weighted average cost of capital (WACC), minus the interest-bearing liabilities. The definitions and assumptions used as the basis for calculating the WACC are listed in the appendix. On this basis, the average WACC in our random survey was 9.77 percent. Thus, the financial value is calculated as follows:

$$\text{Financial value} = \frac{\text{Cashflow}}{\text{WACC}} - \text{Interest-bearing liabilities}$$

In order to obtain the emotional value, the financial value is then subtracted from the minimum acceptable selling price. The calculation is based on all the cases in the random survey which were able to provide all the data required for this analysis.[6] If we compare the mean values of all the factors, we see that the minimum acceptable selling price of the owners in our random survey is, on average, almost one-and-a-half times the actual financial value (see Fig. 8). In other words, the financial value constitutes 70.45 percent, the emotional value 29.55 percent of the minimum acceptable selling price.

Average emotional value and average financial value

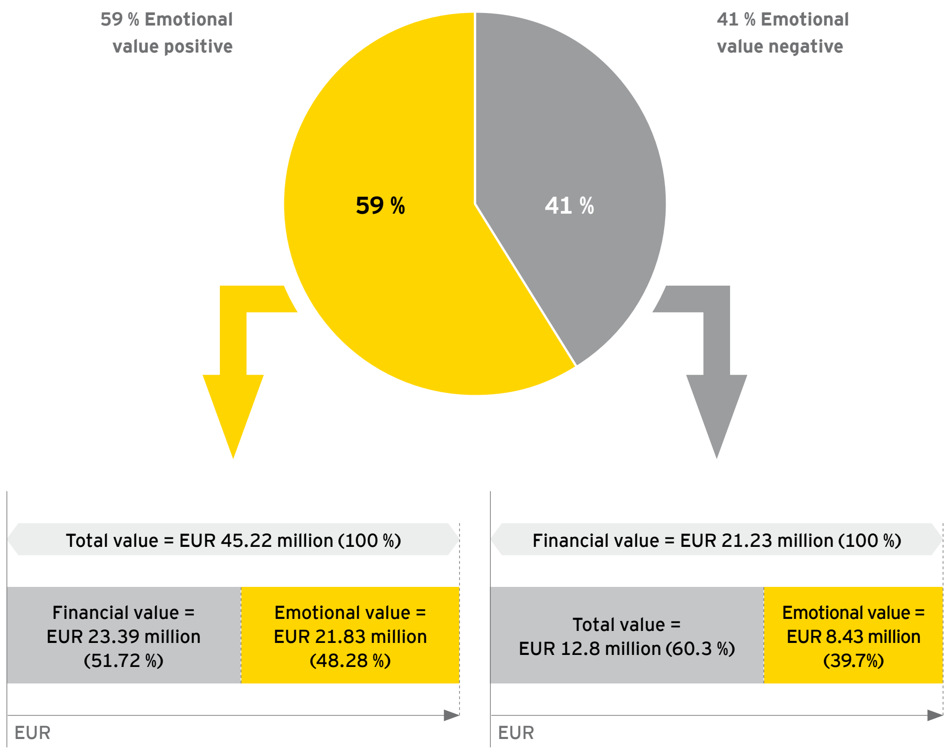
Figure 12

It should be noted that in 41 percent of the cases in our calculation, the emotional value was negative, i.e. the respective owners would be prepared to sell their firms for less than the financial value. It is worthwhile, therefore, examining the positive and the negative cases separately. The findings are shown in Figure 13.

In the cases where the emotional value was positive, this value constitutes 48.28 percent of the selling price, i.e. almost as much as the financial value. A negative emotional value reduced the financial value by 39.7 percent. Thus, the firms in question would be sold for almost 40 percent below the financial value. It should be stressed that the financial value did not have any appreciable effect on whether the emotional value was positive or negative. The average financial value of firms with a positive emotional value was EUR 23.39 million, whereas the financial value of those with a negative emotional value was EUR 21.23 million (see Fig. 13).

Positive and negative cases of emotional value

Figure 13



[5] For this reason, our analysis of the emotional aspects (presented in the first part of this study) which affect the selling prices was conducted separately from our financial valuation of the firms. Rather than calculating the emotional value directly, we took the financial aspects (presented in the first part of this study) into account in our analysis in the form of control variables.

[6] Therefore, we had to exclude some cases from our study. The facts presented in the following are thus founded on a sub-section only of the 171 cases which made up the overall random survey.

7. What are the pros and cons of a positive emotional value?

We have now examined the emotional value owners attach to their firms from several angles. If the emotional value results in a selling price that is over and above the financial value, this can give rise to both advantages and disadvantages.

In our opinion, there are three advantages of a high positive emotional value:

1. One advantage is certainly that owner-managers with a positive emotional connection with their firms will be better placed to survive a crisis. This is very important, especially in view of the current financial crisis. Owners without an emotional connection will tend to sell or give up earlier in the same situation. Moreover, owners with a positive connection may also be prepared to make personal sacrifices, e.g. go without pay for a while, just in order to ensure the firm's survival, as they value their ownership stake in more than just monetary terms.

2. The higher selling price means that more thought will go into the sale. Only those bidders who meet the strict demands (not only of a pecuniary nature) of the seller will be deemed suitable buyers.

In this case, the positive emotional value will help avoid a frivolous sale which could have negative repercussions for both the firm and the entrepreneur.

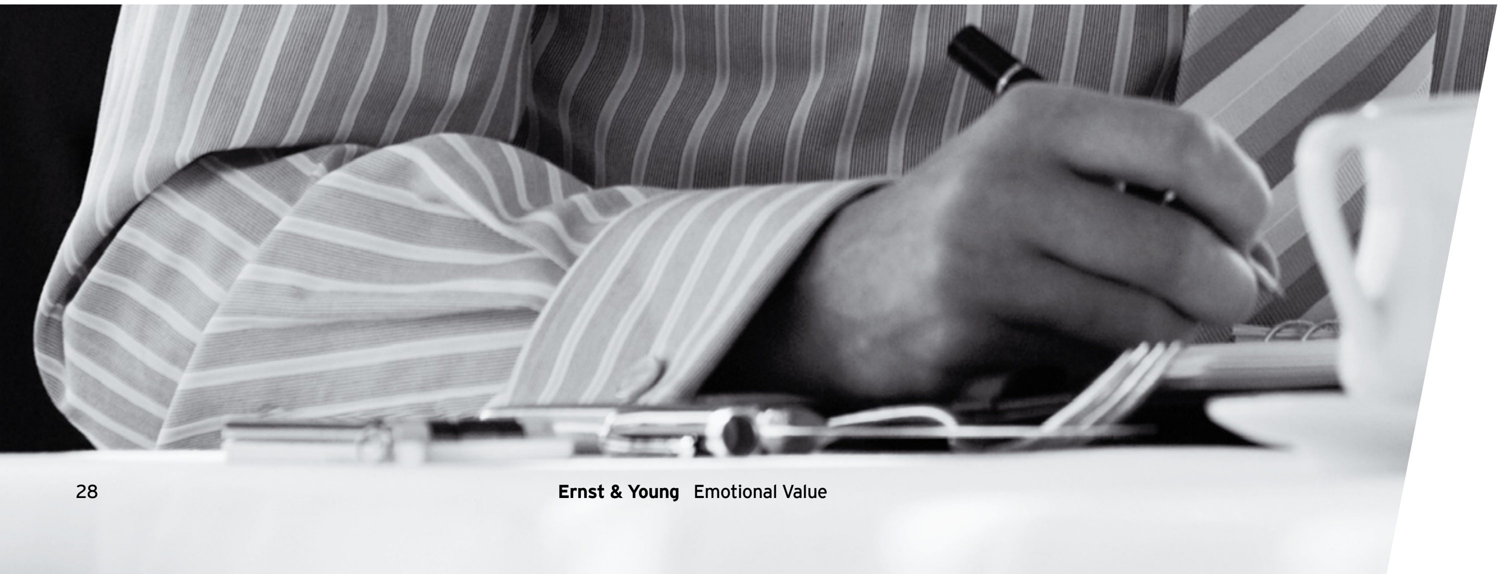
3. A positive emotional connection generates non-pecuniary benefits for the owner, such as pride, status, prestige and joy. The quote by Dupuit at the beginning of this paper suggests that elements such as these provide stakeholders with more lasting satisfaction than mere pecuniary benefits.

... but also several disadvantages:

1. An exaggerated emotional value can render sale of the firm virtually impossible, as hardly any buyer will be willing to pay for this perceived added "emotional value". As a result, succession planning can be delayed and opportunities missed.

2. The ideal time-to-sell can be missed if the owner perseveres with his demand for a top price. External circumstances can, over time, conspire against the firm, ultimately making it a wholly unattractive sale proposition.

3. Placing too great a focus on non-financial benefits can lead to profit discipline in the firm being neglected, a considerable disadvantage in the long term.



8. Conclusions

Generally, the emotional value owners attach to their firms plays a very major role when subjectively valuing the firm. The study's findings, which affect owners, prospective buyers and persons involved in firm valuation alike, will now be presented in brief.

Firm owners
The main aim of the study is to encourage owners to analyze, question and better understand the price they are asking for their firms. The advantages should be weighed against the disadvantages. Founding owners should be aware that, after years of intensive service for the firm, their pricing strategy may have overlooked elements that might be considered valuable by third parties, and that they may sell too cheaply due to a strong desire to leave. If sales negotiations appear to be stalling because, from the seller's viewpoint, the buyer is unwilling to pay, the seller should take a critical look at his asking price to ascertain whether elements such as tradition, length of ownership and past conflicts have, perhaps, been weighted too heavily. Owners of smaller firms, in particular, should be aware that the emotional component in the price is often considerable. Female owners should bear in mind when pricing their firm that a male owner may well ask for a higher price in the same position. Especially in succession scenarios, where the asking price often diverges wildly from what the bidder is prepared to pay, thus preventing a solution from being found, the seller should be aware that, given the above emotional aspects, it may be he himself who is the main obstacle to finding a suitable successor. An effective firm sale requires the owner-manager to "let go" and dismiss any notions of compensation for heightened emotional attachment. And since hardly anyone will share the self-same emotions when bidding for the firm, it is unlikely that the asking price will be met.

In privately held firms with several owners, it is worth asking whether all the owners share equally high emotional values. If not, this could lead to the ownership regime falling apart if some stakeholders want to sell while others still feel very attached to the firm.

Prospective buyers
The study benefits prospective firm buyers in that it can help them better understand the bargaining position of the seller. The findings in the study reveal that for most prospective buyers, there is, in fact, an "ideal" seller. The ideal seller is a founding owner, has been subject to considerable mental and physical strain, has overcome moderately difficult conflicts in the past, sets no store by tradition, and is female. If this is not the case and the asking price diverges wildly from what the bidder is prepared to pay, the latter can try to address the seller's implicit arguments as set out in this study and then propose alternatives. When the asking price is above the financial value of the firm, this is often the result of an exaggerated sense of firm- or family tradition. In cases such as these, therefore, the prospective buyer could try offering to retain the firm name or employing members of the former owning family in some capacity. Other options would be to offer the former owner a place on the supervisory board or another body in the "new" firm. The pros and cons of a such a move should, however, be scrutinized beforehand.

Business valuation experts
Our study demonstrates that conventional valuation methods geared solely to financial indicators overlook several crucial elements. The in-depth study of emotional value and the definition of important influencing factors can provide business valuation experts (M&A consultants, corporate finance specialists and auditors) with alternative options. They will be able to better appreciate the situation of the buyer and the seller and enhance the mediation process between the two parties by proposing solutions based on the findings. Finally, by calculating emotional value using subjective cashflow multiples, we have introduced a general way of quantifying the emotional component and expressing it as a value in euros.

9. Closing remarks and (many) other questions

To sum up, the study shows that a firm owner's minimum acceptable selling price is strongly influenced by emotional aspects. These aspects, in turn, are affected by many different factors. A better understanding of the origins of emotional value on the part of the seller, buyer and valuer can help facilitate corporate transactions and pave the way towards the successful conclusion of succession agreements.

But our study also harbors many unanswered questions. For example: what effect do emotional aspects have on prospective buyers? Do highly desirable objects – "must-have" firms – exist in the corporate world, too? Do emotional aspects go some way to explaining the common construct of goodwill? What effect do emotional aspects have on corporate transactions that have effectively taken place?
Are emotional values culturally dependent? Are they less important in the Anglo-American business context than in Asia? Are some sectors of industry particularly "emotional", while others are more sober?

This study captures only some of the emotional aspects connected with firm ownership; many are still grey areas, uncharted territory awaiting examination.

10. Appendix

Appendix 1: Regression table

Regression analysis for the "phase of ownership"		
Variables	Control model	Full model
Control variables		
Past performance	0.218***	0.232***
Number of employees	0.250***	0.202***
Private benefits of ownership	0.024	0.037
Operating cashflow	0.360***	0.304***
Manufacturing sector, industry	0.188**	0.156**
Services sector	0.081	0.073
Other sectors	-0.028	-0.033
Level of debt (leverage)	0.022	0.052
Knowledge of business valuation	0.101*	0.133**
Long-term investments in the firm	0.225***	0.230***
Independent variables		
Mental and physical strain		-0.213***
Gender (man = 1 woman = 0)		0.084*
Age of owner		-0.085
Percentage of equity in personal ownership		-0.105**
Level of conflict		-0.371*
Level of conflict squared		0.470
How many generations held in family?		0.208***
Adjusted R^2	$R^2 = 0.461$	$R^2 = 0.585$
The dependent variable is the minimum acceptable selling price for 100 % of the equity sold to a non-family member (logarithmized).	* $P < 0.1$ ** $P < 0.01$ *** $P < 0.001$	

The above table shows the result of one of the three multiple regression analyses conducted by us. The control model contains only those control variables which explain the financial value. The independent variables are added for the full model. The figures are the standardized regression coefficients.

The asterisks denote the degree of significance of the individual coefficients. R^2 stands for the explanatory power of the two statistical models, i.e. what proportion of the overall variation in selling price is explained by the factors considered. We used the logarithm (ln) of the dependent variable as the latter has a positively skewed distribution.

The analysis shows that the financial aspects explain 46.1 percent of the variation in selling price. The full model, which takes the emotional aspects into account, explains 58.5 percent of the variation.

Appendix 2: Definitions and expectations for calculating the WACC

Cashflow	Cashflow of the firm according to own figures (defined as net profit + depreciation)
WACC	Weighted Average Cost of Capital Level of debt × Debt costs × (1 – t) + Level of equity × (i + β × (μm – i) + SMCP)
Level of debt (leverage)	According to firm's own figures
Debt costs	Average: 7.5 percent
t	Corporate tax rate (30 percent)
Level of equity	1 – Level of debt
i	Risk-free interest rate: 4.75 percent
β	Betas for various industry sectors
	$\beta_{\text{Manufacturing/Industry}}$: 0.95
	β_{Services}: 1.07
	$\beta_{\text{Health/Social}}$: 0.95
	$\beta_{\text{Hotel and catering}}$: 0.95
	$\beta_{\text{Health/Social}}$: 0.95
	$\beta_{\text{Construction}}$: 0.96
	$\beta_{\text{Retail, Wholesale, Repairs}}$: 0.94
	β_{Other}: 0.97
$\mu_m - i$	Market risk premium for medium-sized businesses, five percent
SMCP	Small and Mid-Cap Premium, nine percent

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The Center for Family Business of the University of St. Gallen (CFB-HSG) in brief

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University of St.Gallen

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