# FAMILY BUSINESS EXIT AND PRIVATE EQUITY INVESTMENT DECISIONS: GOVERNANCE IMPLICATIONS FOR VALUE CREATION

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**Abstract**

This paper was motivated by the increasing interest in the current debate for the entrepreneurial process in family firms. Little research to date has investigated the family business exit and this topic is mainly considered as a failure for entrepreneurial families. However, when uncertainties arise concerning generational succession, the family business exit may enable ownership transitions facilitating survival and long term value creation strategies. Among the exit options, a private equity buyout may balance the family's wealth protection and the firm's future growth. However, which family specific characteristics and strategic needs may affect the exit option still remains a neglected topic. Based on recent research addressing entrepreneurship in family firms and corporate governance literature, this paper develops a case study for investigating the bridging role of private equity buyout for going through strategic transitions in family firms. Findings suggest that a private equity buyout is a governance mechanism which may sustain an entrepreneurial transition by realigning family interests and goals. It may also allow the family commitment for improving organizational capabilities required by an entrepreneurial transition.

**Keywords:** Family Business Exit, Private Equity, Entrepreneurial Process, Corporate Governance, Familiness

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## 1 Introduction

Continuity and enterprise are crucial dimensions affecting the dynamics of family firms, but some of them may lack the required resources and capabilities to manage generational succession (Cabrera-Suarez, De Saà-Pérez and Garcìa-Almeida, 2001; Howorth, Westhead and Wright, 2004; Scholes, Wright, Westhead and Bruining, 2010; Sirmon and Hitt, 2003). Furthermore, many family firms face uncertainties when going through strategic transitions because their current skills, resources and capabilities which enabled their survival may become inadequate to the new strategic needs (Zahra and Filatotchev, 2004). When lacking suitable solutions to incumbent challenges, the family business exit may become the necessary option to ensure the firm's survival and growth (Sharma, Chrisman and Chua, 2003; Sharma and Irving, 2005). Previous studies pointed out the exit as a relevant component of the entrepreneurial process and how it may result in an entrepreneurial renewal (De Tienne, 2010; Wennberg, Wiklund, DeTienne, and Cardon, 2010), but it still remains a neglected topic in family business research. Hence recent literature recognized the need to extend knowledge on what factors impact the effectiveness of the exit as a strategic transition in family firms (Nordqvist and Melin, 2010).

Among the range of alternative options leading to the family business exit, a private equity buyout may be selected by the family owners to protect their wealth invested in the firm whilst ensuring the firm's continuity (Howorth, Westhead and Wright, 2004). Private equity buyouts have been mainly considered as an efficiency mechanism to restructure organizational processes, to downsize workforce and to reduce unit costs (Harris, Siegel and Wright, 2005; Wright, Hoskisson and Busenitz, 2000). However, scarce attention has been devoted to how private equity transactions may enable value creation by fostering entrepreneurial growth opportunities and gaining competitive advantage (Wright, Hoskisson, Busenitz and Dial, 2001; Meuleman, Amess, Wright and Scholes, 2009). Previous studies, mainly rooted in the agency theory, emphasize the monitoring role of private equity firms. The incentive realignment perspective states that the reunification of ownership and control in the post buy-out firm will increase efficiency and performance (Wright, Amess, Weir and Girma, 2009). However, little research has addressed how private equity firms may enable entrepreneurial strategies by providing the resources and capabilities required to overcome strategic transitions. Buyouts usually involve radical changes in the corporate governance of firms and such variations may represent a crucial premise to allow value creation strategies whilst new corporate governance practices may facilitate or obstruct dealing with strategic challenges (Wood and Wright, 2009).

Building on corporate governance literature and recent research addressing linkages between entrepreneurship and family business, this paper focuses on contingencies affecting the family business exit by a private equity buyout through a case study. Ownership and governance issues will be considered with the aim of investigating the effectiveness of post buyout governance practices and their interplay for enabling the family firm's strategic development and ownership transition. We also address how unique family characteristics shape differing combinations of resource diversity and accountability and how they impact on value creation strategies, even exploring potential complementarities or substitution effects among the established corporate governance practices resulting from private equity transactions.

This paper extends previous knowledge by providing new evidence on the topic of entrepreneurial exit in the context of a family firm. Furthermore, it contributes to understanding how the bridging role of a private equity buyback may enable entrepreneurial strategies and long term value creation. Finally, it advances previous research on how corporate governance practices may facilitate or obstruct the pursuit of entrepreneurial strategies in a family firm.

The study is organized as follows: The next section will shortly introduce the study's main theoretical constructs and some missing links in explaining family business exit and the governance role of private equity buyout. Subsequently, the study's research design, data collection and data analysis will be described. In the following sections, after a description of the case study, a specific statement will be delineated on the basis of the case analysis, linking it to the results provided by previous studies. Finally, in the discussion section, the broader implications of the study will be outlined.

## 2 Thearetical background

### *2.1 Definitions and focal firm*

Even though in family business research differing definitions have been suggested, in this paper according to Chua and colleagues (1999) we define a family firm as controlled by families and that has a vision of family influence beyond the founding generation.

We investigated corporate governance in terms of its effectiveness. It addresses the degree of goal attainment by key constituents of the firm and according to the context of the firm's organizational environment (Aguilera, Filatotchev, Gospel and Jackson, 2008:476).

Corporate governance effectiveness depends on a number of differing dimensions and, among them, strategy and resource roles together with promoting managerial entrepreneurship (Filatotchev, Toms and Wright, 2006; Filatotchev, 2007; Aguilera, Filatotchev, Gospel and Jackson, 2008).

Finally, this study focuses on a family firm moving from the entrepreneurial to the managerial stage. Having survived the start up stage it then dealt with additional strategic challenges requiring new, but differing resources and capabilities for sustaining its further growth. Firms like this have been addressed as entrepreneurial threshold companies (Gedajlovic, Lubatkin and Schulze, 2004; Zahra and Filatotchev, 2004). The firm we studied is also consistent with the adolescence phase of its entrepreneurial process as defined in Cardon and colleagues (2005). This stage is characterized by growth, but the firm also begins to establish a formalized organizational structure as well as rules and procedures (DeTienne, 2010).

### *2.2 The exit as an entrepreneurial stage in the context of the family firm*

Entrepreneurship and family business research have traditionally been considered as distinct but overlapping domains of interest a and scanty attention has been devoted to the role of family firms in the entrepreneurial process (Chirico and Nordqvist 2010; Dyer and Handler 1994; Kellermanns, Eddleston, Barnett and Pearson 2008; Nordqvist and Melin 2010; Rogoff and Heck, 2003).

Even though some common topics are well recognized, family business research has been characterized by a prevailing focus on continuity, ownership and leadership succession within the boundaries of the holding family (Le Breton-Miller, Miller and Steier, 2004; Zahra and Sharma, 2004). In contrast, entrepreneurship literature main effort has been directed towards new enterprises, thus considering new ventures, innovation, and renewal (Sharma and Chrisman, 1999). Thus, family business research has neglected the role of families in promoting strategic change, as well as entrepreneurship research has overlooked how the entrepreneurial role is exerted in the specific organizational and cultural context of family firms (Aldrich and Cliff, 2003; Habbershon and Pistrui, 2002). Therefore, according to recent literature (Nordqvist and Melin, 2010; Zahra and Sharma, 2004), a new theoretical perspective is needed for including and explaining how families contribute to value creation in a trans-generational view.

Exit has been traditionally equated with the failure of firms or of individual entrepreneurs both in the fields of entrepreneurship and family business. (Nordqvist and Melin, 2010; Wennberg, Wiklund, DeTienne and Cardon, 2010). Recent research points out the exit as a stage of the entrepreneurial process, thus not as the end of entrepreneurship but as a beginning for new venture opportunities (DeTienne, 2010; Salvato, Chirico and Sharma, 2010; Ucbasaran, Wright and Westhead, 2003). Moreover, despite a prevailing emphasis on equating the exit to failure or success, little research has investigated the exit strategy and its link with the exit decision (Wennberg, Wiklund, DeTienne, 2010).

Addressing the link between entrepreneurship and family business leads to consider the latter as an organizational context where unique characteristics may affect entrepreneurial processes (Nordqvist and Melin, 2010). In this view, the exit may be interpreted as a stage along the entrepreneurial path, but little research to date has investigated how it may be influenced by family's certain characteristics (DeTienne, 2010; .Habbershon and Williams, 1999; Niedermeyer, Jaskiewicz and Klein, 2010; Salvato, Chirico and Sharma, 2010; Sirmon and Hitt, 2003, Zellweger, 2007).

### *2.3 The value creation dimension of corporate governance and private equity buyout*

The corporate governance research has been mainly rooted in the agency theory with the aim of protecting the firm's value by reducing inefficiencies arising from conflicting interests (Filatotchev, 2007). However, going through strategic transitions, the value creation dimension of corporate governance may also become relevant, but the agency theory has shortcoming when considering entrepreneurial firms pursuing growth which may require changes in their resource base (Filatotchev, Toms and Wright, 2006; Zahra and Filatotchev, 2004). Competitive advantages are built upon the possession of valuable, rare, imperfectly imitable and non replaceable resources idiosyncratic to the firm (Barney, 1991) and well known drivers may be new products or new processes creating performance differences among firms (Danneels, 2002). Furthermore, in addition to the firm's resource base, organizational and strategic processes are also relevant to promote the manipulation of resources into value creating strategies (Chirico and Nordqvist, 2010). Individuals holding power positions, such as senior managers or board members, can play a role in the development of capabilities by undertaking specific initiatives and establishing organizational routines. Governance issues in family firms may become potentially more complex than in non family firms, because of the interwoven systems of ownership, management and family (Westhead, Cowling and Howorth, 2001). The organizational value creating attributes are embedded in the firms' system of corporate governance and relies upon differing incentives, authority structures and norms of accountability (Carney, 2005). The involvement of family members in ownership and/or in management may influence the firm's strategic decision making, conditioning topics such as the goals pursued, time horizons, or the development of organizational capabilities (Sirmon and Hitt, 2003; Le Breton-Miller and Miller, 2006; Uhlaner, Wright and Huse 2007). Investigating how family members exert their power and responsibilities influencing strategic transitions may provide useful explanation on the topic of value creation over time in a family firm (Brunninge, Nordquist and Wiklund, 2007; Chirico and Nordqvist, 2010; Gedajlovic, Lubatkin and Schulze, 2004; Scholes, Wright, Westhead and Bruining, 2010).

Previous studies address private equity buyouts as a governance mechanism for rapidly and radically restructuring organizations worldwide (Wright, Amess, Weir and Girma, 2009:353). Private equity buyout may represent a suitable solution for family firms when they lack resources and capabilities required for going through strategic transition or when they are faced with succession uncertainties (Dawson, 2010; Howorth, Westhead, and Wright, 2004). Distinguishing characteristics of private equity buyouts rely upon a recognized bundle of mechanisms shaping the governance structure and represented by an active monitoring function exerted by the private equity firm, high leverage and close ownership under management control (Wright, Amess, Weir and Girma, 2009). Private equity investment decisions are characterized by uncertainty and time constraints, but they aim at increasing the targeted value of the firm over a 5-10 year period. Private equity buyouts have been frequently presented as improving efficiency in resource allocation processes (Cumming, Siegel and Wright, 2007; Scholes, Wright, Westhead and Bruining, 2010; Wood and Wright, 2009). For example, they may improve performance by cutting agency costs stemming from non economic goals affecting family firm performance, such as creating jobs for the members of the owner-family (Chrisman, Chua and Litz, 2004; Sharma, Chrisman and Chua, 1997). Otherwise, they may lead to strategic growth by providing required resources for upside the firm entrepreneurial opportunities (Meuleman, Amess, Wright and Scholes, 2009; Wright, Hoskisson, and Busenitz, 2001; Wright, Hoskisson, Busenitz and Dial, 2000; Wood and Wright, 2009). However, little research to date has investigated how private equity buyout may sustain value creation strategies in entrepreneurial firms by ensuring the development of internal resources such as managerial and organizational capabilities.

## 3 Methods

### 3.1 Empirical setting

This paper develops an inductive inquiry (Glaser and Strauss 1967) carried out through an in-depth longitudinal analysis of a revelatory case (Yin, 1994). As we were interested in understanding the exit as a phase of the entrepreneurial process of a family firm both at family and a firm level, as well as its correlated governance implications, Tieffe seemed a suitable case to investigate. In selecting research sites, the goal is to identify available cases that are likely to replicate or extend theory, rather than randomize (Eisenhardt, 1989), and that are promising in providing rich empirical data on the investigated phenomenon, based on a plurality of data sources (Yin, 1994). This company is a small Italian family firm which manufacturers hydraulic hose fittings and adapters. Since its establishment this company was held by a dominant coalition of families (Chua, Chrisman and Sharma, 1999). Although it went through recursive governance changes, the entrepreneurial role was clearly identified in one of the founding owners. With the announcement of his intention to retire, Tieffe faced trans-generational uncertainties which influenced the family business exit (Nordqvist and Melin, 2010). Hence the private equity buyout acted as a governance mechanism (Wright, Amess, Weir and Girma, 2009) which resulted in a strategic transition of the firm and a realignment of the family's interests and goals. Our analysis examines contingencies affecting the exit decision and how it was carried out by the private equity buyout. After a brief description of the methods employed for data collection and data analysis, we discuss our empirical evidence.

### 3.2 Data Collection

Data were collected through personal interviews and secondary sources over a period of six months in 2010-2011. Aiming to investigate the research topics in depth, we conducted our case study relying on interviews with several people aimed at representing differing perspectives (Myers, 2009). Interviews were the primary source of data and we relied on informants chosen on the basis of their role within the governance and organizational structure and of their involvement in the transition process. At first we identified the key informants as individuals having the most information about our specific topics of interest. Furthermore, interviews were extended to all individuals known to have significant information because of their knowledge and involvement in the transition process under analysis (Myers, 2009).

Semi-structured interviews were conducted separately with individuals representing owners, board members, and managers. We also interviewed private equity and Tieffe consultants because of their involvement in the private equity buyout or because of their longstanding knowledge both of the family and the firm.

We interviewed informants from the entrepreneurial family included active members from the first and the second generation, aiming at deepening their own view regarding the family business exit and the following transition process to yield a more accurate analysis (Yin, 1994). Interviews were conducted during several formal and informal meetings having an average length of two hours and half. The interviews were audio-recorded and transcribed after each meeting. After each interview we had a discussion based on the impressions and written notes taken during the interview, and then noted our observations to crystallize the ideas (Bryman and Bell, 2007).

In order to achieve internal reliability of the study, interviews were listened to by two members of the research team with the purpose of checking for consistent interpretation (Bryman and Bell, 2007). Furthermore, after the interviews written notes were shared and matched by the researcher to check data and identify diverging interpretation. Ambiguous information or interpretation was clarified by asking confirmation of the respondents by telephone.

Interviews were organized in two parts. Initially, open-ended questions were asked without specifying the constructs of interest in the research project to the interviewee, so as to avoid_influencing their answers. We let the respondents tell their story on the firm's entrepreneurial process and on its corporate governance along its evolutionary path (i.e. overview of the family business' history, crucial events and steps referring to the firm's strategic behaviour and changes, general information about the corporate governance practices and their variations over time, the involvement of family members).

We focused the case study on the transition involving the family business exit and the private equity buyout which occurred in 2008, but we acquired further data regarding the previous history of the firm for a better interpretation and contextualization of events and roles of the individuals involved holding key positions. Data on previous events were a relevant source for understanding the family and organizational specificities, allowing a multiple level analysis.

During this part of the interviews, we asked in depth questions to obtain more details on the topics discussed and to triangulate the data acquired (Yin, 1994). In the second part of the interviews, structured questions were asked in order to investigate the role played over time by specific family and business characteristics as well as corporate governance practices (i.e. entrepreneurial role, board composition, information regarding family members' characteristics, involvement, goals and motivations influencing the entrepreneurial exit and the private equity buyout decision), their mutual interplay and potential complementarities or substitution effects. The aim was to investigate the outcome of the established governance arrangements as a whole and the following degree of effectiveness in supporting the firm's strategic needs throughout the entrepreneurial exit process.

Secondary data were collected by multiple sources. (Table 1 provides a list of the main secondary sources employed in this study). Secondary sources allowed us to build longitudinal accounts of the intervening variations in the corporate governance structure, allowing us to identify critical events, potential links and contribute to build up a description of the organization and of its history (Bryman and Bell, 2007). It also enabled us to analyze formal agreements regarding, for example, incentives, expected performance rates, and corporate governance arrangements involving the private equity transaction. This information helped us to better understand the role of the private equity and its relationship with the entrepreneurial family. Furthermore, we used a range of sources of data to provide a rich and robust foundation for theory development.

**Table 1.** Main secondary data sources

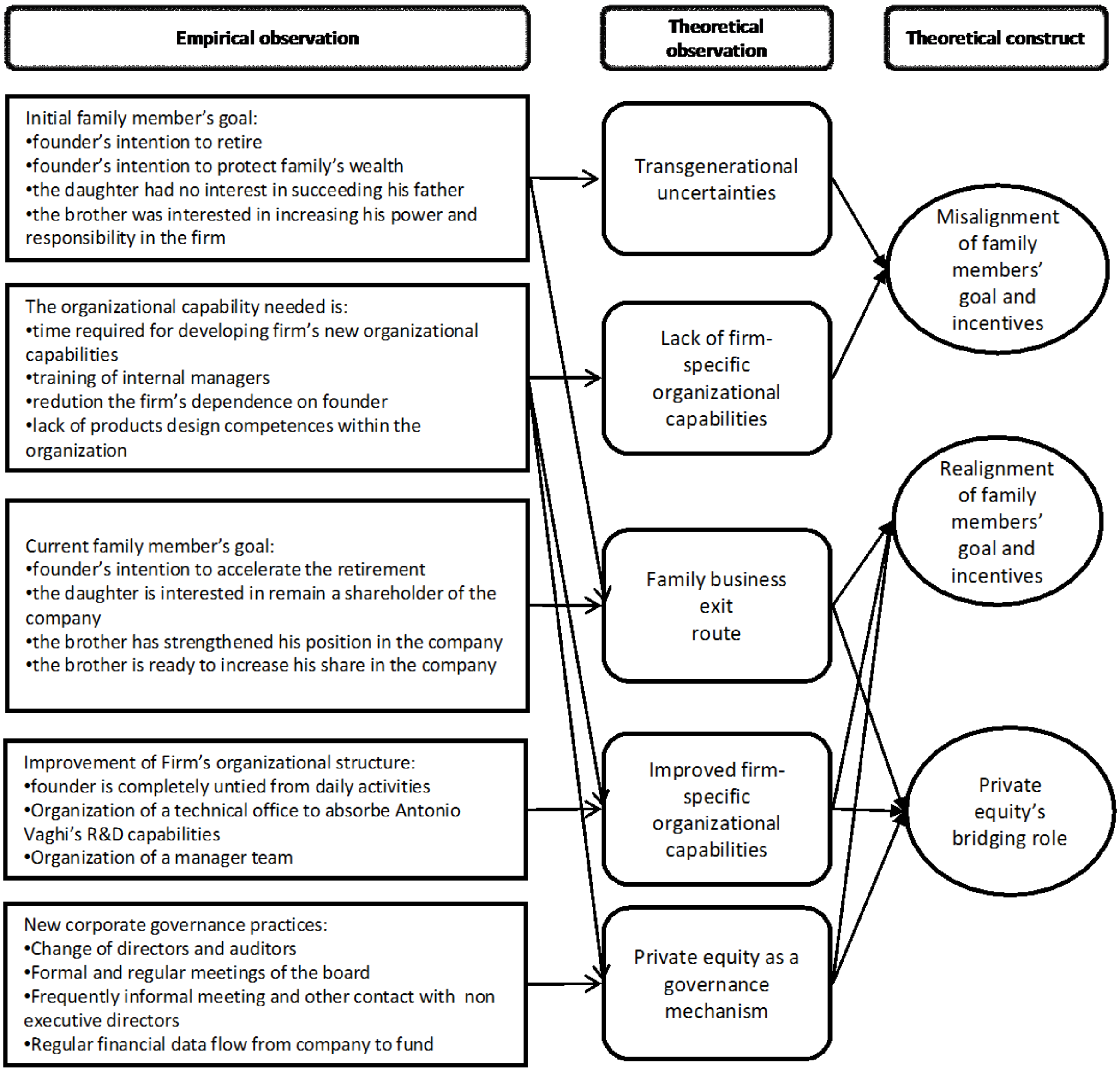
- Financial reports (10 years)
- Official Business Register of the Italian Chambers of Commerce (from 1976 to date)
- Company website as of January, 2011
- Commercial catalogues
- Internal reports
- Buyout agreement
- Company documents and partners agreements
- Financial Press and newspapers articles.

### *3.3 Data Analysis*

Data analysis was guided by theoretical concepts regarding the entrepreneurial process in family firms and the value creation dimension of corporate governance and we employed an iterative cycle of analytic induction and deduction (Eisenhardt, 1989). A multiple researchers approach allows triangulation, with the aim of analyzing data from different perspectives (Myers, 2009). Therefore, we triangulated data among respondents, who were required to tell their stories so as to obtain information from their individual point of view. Then we triangulated data acquired from interviews with data from secondary sources, such as published and unpublished documents. We stored the collected data in a data base specifically designed for the task of structuring and clarifying information and then we repeatedly iterated between data and theoretical constructs (Bryman & Bell, 2007). In a first phase, we addressed each construct separately and then we tried to explore emerging relationships among the identified constructs. We carefully read interview transcripts, observations and secondary data to identify and refine patterns. During the data analysis we generated memos and then matched them to refine theoretical understanding (Yin, 1994). The emerging theoretical constructs developed by the memos were compared to the evidence for evaluating their fit with data in an iterative process (Yin, 1994; Eisenhardt, 1989), often generating new and more finely detailed memos which became the basis for the presentation of the research findings. Some findings were consistent with the initial theoretical framework, but further insights also emerged and suggested refinements in the theoretical guide. This way allowed coding the new observation into themes and widening our theoretical framework. We early realized the relevance of the link between the family's and the firm's dynamics affecting the exit decision. Hence, by deepening the analysis we identified antecedents of the family business exit and how corporate governance variations by the private equity transaction impacted the entrepreneurial family exit while providing incentives to their commitment in the firm's growth. Hence data analysis was undertaken by an iterative interplay between empirical and theoretical observations which led to our theoretical constructs (Locke, 2001). Figure 1 shows our data structure.

Correspondence between our theoretical insights and empirical observations were verified by follow up meeting with key informants. They also enhanced the internal and external validity of our theoretical findings. Then we presented our findings to academic colleagues to ensure the validity of our analysis and theory building during several informal and formal meetings.

**Figure 1.** Data structure




## 4 Findings

In this section we report our research findings by explaining our empirical observations and the theoretical insights originated (Eisenhardt and Graebner 2007).

### *4.1 Case description*

Tieffe was established in 1976 as Tecnoflex, thanks to the entrepreneurial successful experience of Antonio Vaghi, its first CEO. Unlike most Italian companies, Tecnoflex stock wasn't entirely held by its founder, who only owned a minority share.

Tecnoflex was originally set up as a productive branch of Flextubo, a company from the hydraulic sector established in Modena, a town in Northern Italy. Antonio Vaghi, previously a sales representative in Flextubo, was put in charge of managing the new company and was therefore assigned a 20% of its stock share.

### *4.2 Industry overview*

Hose fittings belong to the main sector of hydraulics, whose Modena district is one of the most important in the world. Hose fittings are metallic ends of flexible hoses conveying driving force into hydraulic circuits. Given the high oil pressure inside the pipes, hose fittings' main features must be resistance, steadiness of their connection with the pipe, along with low costs and fast installation. This is the reason why a close cooperation between flexible hoses and hose fittings producers is crucial in order to develop and implement new solutions suitable for both parts.

This specific connection shapes the strategic features of the sector, divided into three types of players: pipes producers, hose fittings producers and assemblers. Each one of these businesses has different features: pipes producers are economies of scale highly sensitive, because of the considerable investments for production and research, and have nowadays mainly been absorbed by a few multinational companies from the rubber and tires sector; hose fittings manufacturers, on the other hand, have much lower entry levels on the market, therefore the existence of small to medium businesses, like Tieffe. In this field, innovation and technologies are the nodal point, in fact, after products development in partnership with pipes producers, their economic life is quite long and these joint ventures might last years. Finally, assemblers are those buying both pipes and hose fittings to assemble and sell them to end consumers: this business' technology is easily acquirable, entry levels are therefore low, and crucial features here are commercial ones, along with services.

This significant interdependence resulted into a progressive concentration of the companies from this sector into vertically integrated ones, able to perform internally all the three productive steps. Experts, nonetheless, consider this an inevitable and inescapable process, whose timing, though, is not undifferentiated: while all US producers are, in fact, vertically integrated, in Europe sectorial producers are fewer but stronger.

### 4.3 Company overview

The firm's evolutionary path can be parted into four main phases.

During the *first phase* (1976 – 1994) Antonio Vaghi from salesman became entrepreneur of the Piacenza facility gaining, rapidly, more and more managerial autonomy. The legitimization and authoritativeness achieved by Vaghi in the hose fittings industry was such that Mr Gennaro Calanchi, the youngest of the company's members, decided to come to an end the twenty years long partnership in Flexotubo with Mr Luciano Ferrarini in order to work with Vaghi in the hose fittings manufacturing.

The *second phase* (1994-1999) starts from the breakup with Flextubo up to the appointment of Giovanni Vaghi, Antonio's brother, as director in Tieffe. In this period Antonio Vaghi was running the company as an independent entrepreneur, also by an agreement stating that all strategic decisions should require accordance among the owners despite their differing shares. Antonio Vaghi, despite the significant growth in sales, did not have the skills necessary to give the company an equally significant improvement in terms of organization. His entrepreneurial style, in fact, revolved around his technical role and daily presence in the company and his strategies were basically focused on innovation and production. Antonio Vaghi soon acknowledged that his involvement in the day to day running of the business, along with low delegation, caused his physical presence to be essential even for the most ordinary issues. This not only was slowing the company's development, but was also forcing him to neglect his most important activity for the company: the new products development.

The *third phase* (1999-2005) is characterized by an organizational improvement. This phase began when Giovanni Vaghi was appointed as director, up to the conveyance of the majority of shares to the private equity Cape fund. The company, thanks to Giovanni's managerial experience and personals skills, as well as to his family ties with the entrepreneur, was reorganized in a more structured way. Giovanni defined a specialized organizational structure implementing a real information system with the aim of a constantly check of the company's performances. Thanks to a steady process of legitimization, also endorsed by Mr Calanchi, was possible to Giovanni Vaghi to take over the major part of Antonio's daily activities. In this way Antonio was allowed to convey his time and efforts into other strategic practices like R&D. The introduction of structured planning and control systems, coupled with the stable involvement of the board of directors, allowed for a better rationalization of investments and an overall improvement of company performance. In this period a new dilemma was arising: the generational transition. Many was the reasons leading to consider the owners' sons not suitable for the role of successors in Tieffe. Mr Calanchi's son, Elis, showed a scarce interest for Tieffe, preferring, instead, his role in OM , another firm owned by his family and sited in Jesi, operating in the hose fitting industry, where, since from 1999, he was involved in a managerial position. Lara Vaghi, Antonio's daughter, nowadays accountant in Tieffe, lacked technical expertise and was rather unwilling to run for her father's position thinking to have not to her father's charismatic personality.

The *fourth phase* (2005-nowadays) is characterised by the fund entrance in the company's ownership. Starting from 2005 the private equity transaction began to be considered as a viable solution for the succession issue. A previous experience with a foreign partner company (Czech Republic), proved it could be a flexible and suitable way for the finalizing of the company's de–personalization. The operation would allow the monetization of part of the owners' assets and the later passage of the company to an industrial partner. deal with the Cape fund was signed in 2008 for the conveyance to it of 60% of company stock shares.

The fourth phase is still in progress. The next step will carry to Antonio Vaghi's withdrawal from the firm's management and the consequent taking over by his brother Giovanni. This project require the creation of an engineering team necessary to take over gradually the research and development activity now centered on Antonio's role. A stock option plan has already been outlined by the new management in order to successfully finalize the succession process.

The new organization counts on the definitive exit of the Calanchi family who has already started from 2007 its progressive disengagement. In 2007 OM in Jesi was unbundled by Tieffe and then acquired by Calanchi's family. Nowadays the Vaghi family thereby remains the sole representative from the founding ownership and holds the operative delegacies, with Antonio Vaghi as Chairman and Giovanni Vaghi as CEO. Instead the private equity firm holds the majority in the board of directors by three representative, without delegacies and with mainly controlling and advisory tasks. Moreover, one of the member of the board is in charge of constantly monitoring the manage offering his support to the CEO in financial issues. This organization reflects the will of Calanchi's family to carry their share to 16,5% allowing to Giovanni Vaghi to increase his share to 7%, a sort of award for the successful operations and for his new managerial and entrepreneurial role.

## *4.4 Antecedents of entrepreneurial exit: a multilevel perspective leading to the private equity option*

### *4.4.1 Corporate governance and the need of improving the firm's organizational capabilities*

Tieffe is a small family firm which, since its start up as entrepreneurial venture and up to the private equity buyback, was owned by a dominant coalition of families. Among the founding owners, Mr Antonio Vaghi, holding 20% of the shares, was delegated to running the business, while the remaining owners, namely Mr Calanchi and Mr Ferrarini, provided financial capital and served as Directors keeping a monitoring role. Acting as the entrepreneur, Antonio Vaghi independently took charge of the development of both manufacturing and selling activities. His undisputed entrepreneurial leadership went through the recurring ownership and governance changes affecting Tieffe along years. It also led to a strong identification between Tieffe and Antonio Vaghi, both among the internal and external stakeholders, such as customers, suppliers, the banking system and so on. However, Antonio Vaghi never gained the majority of the shares and he only reached 50% of the shares when one of the founding member sold his shares in 1994. Table 2 provides a list of governance changes the firm went through since its establishment.

The entrepreneur's efforts for expanding the company were driven by a strong focus on developing innovative and high quality products. For many years and up to the appointment of his brother to the Board in 1999, he never paid dividends, but constantly devoted all the available resources to the firm's activities and to investments. He extensively invested in new equipment for improving automation in the manufacturing processes and for increasing the quality and performance of the products. In fluid power hose fittings manufacturing, a critical concern relates to avoiding the hose's detachment due to the high pressure of the fluid. Even though this product is apparently simple and of small value, it's quality and performance are crucial when employed, because hose fittings ensure the transfer of driving power by high pressure fluids. Furthermore, a detachment may become highly dangerous for employees working nearby, given the fluid's high pressure. By innovating machinery and automated processes, Tieffe expanded over the years and it is currently recognized as one of the major manufacturers of hydraulic hose fittings and adapters in Europe. However, as a consequence of his frequently relinquishing dividends for investing in the modernization of the firm, the family's wealth was highly concentrated in the value of the firm.

A further crucial requirement for gaining competitive advantage is product design and Antonio Vaghi developed personal skills and expertise leading to distinguished high performance products. Over the years, he personally designed a range of successful products, gaining a distinctive reputation. For example, a particular nut which took the name of the company and which ensures superior technical characteristics and performance is well known within this industry. Furthermore, hose manufacturers are unable to rapidly switch to a rival supplier of hose fittings because years of research and development are required to ensure perfect adaptation and good functioning. The entrepreneur's personal capability and reputation were, therefore, a well recognized driver of the Tieffe's growth in the long term.

Collected data show that a main factor in Tieffe's evolutionary path was its organizational adaptation to growth. Antonio Vaghi's background lacked managerial experience and he concentrated power. Therefore, Tieffe's growth was accompanied by emerging organizational inefficiencies which affected performance. Aiming at improving the firm's managerial skills and expertise he appointed a number of external managers who were, however, subsequently fired because results were inadequate. In 1998 he made a proposal to his brother Giovanni Vaghi to retire from his current employment so as to take charge of the Tieffe's organizational restructuring. Giovanni Vaghi was a manager with long standing experience in a multinational company. He had worked 22 years in IBM Italy, where he had reached a high level position. Therefore his professional background was a significant resource for addressing organizational improvements and for introducing managerial techniques and expertise. Furthermore, by the appointment of Giovanni Vaghi as a Director, Antonio Vaghi was able to reduce his involvement in managerial tasks so as to increase his efforts in R&D activities in the development of new products.

We found evidence that the appointment of Giovanni Vaghi led to a substantial change in the firm's growth trajectory. By the entrepreneur's empowerment, Giovanni Vaghi carried out substantial organizational restructuring. He brought his managerial experience into Tieffe and addressed changes in the organizational structure and processes. For example, he substituted employees in positions of responsibility and promoted professionalization of young internal employees through training activities and power delegation. Moreover, Giovanni Vaghi developed informative systems, improved performance measurement systems and introduced planning and control systems as shared managerial tools and techniques for running the business. His goal was not merely to improve organizational efficiency, but also to reduce the firm's dependence on Antonio Vaghi's involvement and leadership by the improvement of the firm's organizational capabilities. Changes were progressively carried out over the next few years, and performance improvements followed. However, organizational changes didn't involve the development of new products because it was personally supervised by Antonio Vaghi. Therefore, we found evidence of the beginning of a strategic transition from an entrepreneur-centred firm towards a managerial one by the appointment of a family member serving as a Director. Changes in the firm's resource base complemented the board variation which provided new competences and task specialization among Directors. Changes were sometime disruptive, but because of their affective relationships Antonio and Giovanni Vaghi carried out the organizational adaptation without conflict.

When Antonio Vaghi in 2005 matured his intention to retire, Tieffe faced succession uncertainties, because it was still dependent on the entrepreneur's core competence on product design. Tieffe's survival required new organizational capabilities ensuring the development of distinctive products, but neither family members, nor employees were able to provide such a resource. Therefore, we found evidence that the need of changes in the firm's organizational capabilities, linked to the lack of this crucial competence inside the family influenced the family business exit decision when faced with the problem of generational succession.

**Table 2.** Governance variations

| Year | Event | Ownership composition | Board Composition | Entrepreneur role |
|---|---|---|---|---|
| ante 1976 | Flextubo foundation | Ferrarini Luciano 50%<br>Calanchi Gennaro 50% | Ferrarini Luciano *(Chairman of the board)*<br>Calanchi Gennaro *(CEO)* | Antonio Vaghi sales representative |
| 1976 | Tecnoflex foundation with head office in Piacenza | Vaghi 25%<br>Flextubo 75% | Ferrarini Luciano *(Chairman of the board)*<br>Vaghi Antonio *(Executive Director)*<br>Lazzari Angelo *(Executive Director)*<br>Savoia Desiderio *(Executive Director)* | entrepreneurship beginning |
| 1991 | Merger Tecnoflex-Flextubo | Ferrarini Luciano 40%<br>Calanchi Gennaro 40%<br>Vaghi Antonio 9%<br>Villa Tamara 3% *(Vaghi's wife)*<br>Lazzari Angelo 2% *(manager)*<br>Tosi Sergio 2% *(manager)*<br>Savoia Desiderio 2% *(manager)*<br>Betta Giovanni 2% *(manager)* | Ferrarini Luciano *(Chairman of the board)*<br>Vaghi Antonio *(Executive Director)*<br>Lazzari Angelo *(Executive Director)*<br>Tosi Sergio *(Director)*<br>Savoia Desiderio *(Executive Director)*<br>Calanchi Gennaro *(Executive Director)*<br>Ferrarini Alberto *(Director)* | CEO of Flextubo and plant manager of the production departement of Piacenza |

**Table 2.** Governance variations (continuation)

| Year | Event | Ownership composition | Board Composition | Entrepreneur role |
|---|---|---|---|---|
| 1993 | Tieffe S.r.l. foundation conferring with the production departments in Cura Carpignano and Piacenza | Flextubo 100% | Vaghi Antonio *(Executive Director)* Lazzari Angelo *(Executive Director)* | CEO of Tieffe |
| 1994 | Flextubo - Tieffe division | Vaghi Antonio 15% Villa Tamara 5% *(Vaghi's wife)* Calanchi 80% *Vaghi and Calanchi agree to manage the company as to have egual amount of share* | Calanchi Gennaro *(Chairman of the board)* Vaghi Antonio *(CEO)* Lazzari Angelo *(Director)* Calanchi Elis *(Executive Director)* | Disagreement between Ferrarini and Calanchi. Vaghi and Calanchi acquire the prodution division (Tieffe), |
| 1995 | Giovanni Vaghi becomes director of Tieffe | unchanged | Calanchi Gennaio *(Chairman of the board)* Vaghi Antonio *(CEO)* Calanchi Elis *(Executive director)* Lazzari Angelo *(Director)* Giovanni Vaghi *(Director)* Negri Luigi *(Director)* Riccardi Luigi *(Director)* | Antonio Vaghi asks his brother to join the Board of Directors to bring management experience |
| 1999 | Giavanni Vaghi becomes CEO of Tieffe and he begins to work in the company | Calanchi Gennaro 72% Calanchi Elis 4% *(Calanchi's son)* Calanchi Elena 4% *(Calanchi's dauther)* Vaghi Antonio 20% | Calanchi Gennaio *(Chairman of the board)* Vaghi Antonio *(CEO)* Calanchi Elis *(Executive Director)* Vaghi Giovanni *(Executive Director)* Negri Luigi *(Director)* Riccardi Luigi *(Director)* | Giovanni Vaghi works full-time in the company: he becomes executive director and plays the role of CFO |
| 1999 | Elis Calanchi becomes CEO of OM Oleodinamica S.r.l. a subsidiary company with head office in Jesi (AN) | unchanged | unchanged | Traduzione da italiano verso inglese |

**Table 2.** Governance variations (continuation)

| Year | Event | Ownership composition | Board Composition | Entrepreneur role |
|---|---|---|---|---|
| 2001 | Antonio Vaghi increases his share at 50% through a real estate spin-off | Calanchi Gennaro 42%<br>Calanchi Elis 4%<br>*(Calanchi's son)*<br>Calanchi Elena 4%<br>*(Calanchi's dauther)*<br>Vaghi Antonio 50% | unchanged | The oldest son of Calanchi takes over the management of OM. |
| 2005 | Antonio Vaghi sells 2% of share to his brother Giovanni | Calanchi Gennaro 42%<br>Calanchi Elis 4%<br>*(Calanchi's son)*<br>Calanchi Elena 4%<br>*(Calanchi's dauther)*<br>Vaghi Antonio 48%<br>Vaghi Giovanni 2%<br>*(Vaghi's brother)* | Calanchi Gennaio<br>*(Chairman of the board)*<br>Vaghi Antonio *(CEO)*<br>Calanchi Elis<br>*(Executive Director)*<br>Giovanni Vaghi<br>*(Executive Director)*<br>Riccardi Luigi<br>*(Director)* | The Vaghi's brother becomes to shareholder of Tieffe |
| 2007 | Tieffe sells its share in OM Oleodinamica to Calanchi's family | unchanged | unchanged | OM exits from the group and becomes a company of Calanchi's family |
| 2008 | Private Equity Fund acquires 60% of share of Tieffe through a LBO | Perroni Maurizio 3,6%<br>*(manager- Private Equity Firm)*<br>Cape Natixis 53,71%<br>Cape due team 2,69%<br>Calanchi Gennaro 16,5%<br>Vaghi Antonio 14,5%<br>Vaghi Giovanni 7%<br>*(Vaghi's brother)*<br>Vaghi Lara 2%<br>*(Vaghi's Daugther)* | Vaghi Antonio<br>*(Chairman of the board)*<br>Giovanni Vaghi<br>*(CEO)*<br>Perroni Maurizio<br>*(Director)*<br>Cimino Simone<br>*(Director)*<br>Bortot Marco<br>*(Director)* | The Calanchi's family leaves the board of directors, Antonio Vaghi becomes Chairman of the board and Giovanni Vaghi becomes CEO |

#### *4.4.2 Misalignment of goals, incentives, and time horizons among family members and the private equity buyout decision*

Even though family members agreed on going through entrepreneurial exit, data from interviews showed substantial differences in their goals, incentives and time horizons which influenced the decision to carry out the private equity buyout option.

The founder's intention to retire, which was the starting point of the entrepreneurial exit, was motivated by personal stress throughout his professional life. Being nearly sixty years old, he had started thinking of his future outside Tieffe, but was interested in protecting his family's wealth by taking advantage of the increase in the firm's value. Because of the governance structure since the firm's establishment and the number of variations it went through over the years, he felt himself as the entrepreneur more than the owner and therefore the selling of the shares was an option he had always considered.

Industry uncertainties were also supporting his intention of selling the company, because of the tendency of mergers leading to vertically integrated manufacturers producing assembled hoses and hose fittings. Tieffe had been able to establish itself due to the distinctive quality and performance of its products, but the future necessity of joining an industrial partner could not be excluded. As an example, in 2001 a major hose manufacturer started negotiating the takeover of Tieffe, but the Vaghi family did not trust the strategic perspectives, and therefore the deal fell through.

Antonio Vaghi's daughter, namely Lara, was working in Tieffe, but she was not confident in her succession because she lacked both the technical and commercial background. She was currently involved in administrative tasks and, at the time when the exit decision matured, did not seem interested in taking a high responsibility position. Hence Antonio Vaghi preferred to offer her capital not invested in the firm.

Even though his incentives were consistent with selling his shares, Antonio Vaghi was strongly interested in Tieffe's survival in the long term. He wanted to address the ownership transition by selecting an appropriate industrial partner to shape the new ownership structure. Hence, he was available to take a consultancy role for developing a new range of products ensuring the firm's survival and growth in the future. Therefore, a private equity buyout may represent the appropriate governance mechanism allowing a transition stage requiring a mid term time horizon, despite his departure.

In contrast, Giovanni Vaghi, holding 2% of the shares, was less interested in taking advantage of the firm's value, but rather in aiming at increasing his power and responsibilities within the firm. He was fifty two years old and so he was not thinking of retiring. He was at the height of his professional life and he had left his previous managerial career to become an entrepreneur. Furthermore, he was the leader of the firm's ongoing organizational transformation, but he required time for reaching his goals. Hence a leadership succession from Antonio Vaghi to Giovanni Vaghi was not considered satisfying because the latter lacked a technical background and the organizational transition was still uncompleted. Moreover, he also found carrying out a private equity buyout consistent with his interests and goals because it could lead to a first step in the governance transition ensuring his rise both in the ownership structure and inside the board. He also could take advantage of the time required for completing his task.

Members of the Calanchi's family were not interested in leadership succession. Both the founding partner and a son of his were involved in managing their own distinct firm and were mainly interested in the value of their shares. Furthermore, the goals and interests misalignment among the owners didn't result in conflicts. Hence they evaluated the range of alternative exit options aimed at finding a balanced solution and agreed to carry out the private equity buyout as the most suitable one.

Therefore collected data show that misalignment involving family members' goals, interest and incentives emphasized succession uncertainties and led to the family business exit. However, it also influenced the choice among the alternative exit options. The private equity buyout acted as a governance mechanism enabling the bridge to a new ownership and governance structure which currently is not settled, but that will be shaped by the influence of the entrepreneurial family. Moreover, the transition may give the opportunity for realigning the family members incentives and goal sharing because the private equity firm required their commitment and their involvement in governance and managerial positions.

## 4.5 Going through generational transition: corporate governance practices affecting the exit effectiveness

### *4.5.1 Organizational skills and overcoming of dependence on the entrepreneur'*

Developing organizational skills had been Antonio Vaghi's objective since the mid 90s, even before his brother entering the business. He had tried many times hiring a general manager, though never having found the right man for the job. He acknowledged, in fact, that without an organizational structure and delegacies, he couldn't properly improve the company, all his time and energies being devoted to daily management. The new role of his brother, in 1999, giving the company a structure and implementing management control, progressively improved the situation, though a few glitches were encountered in specializing functions, unwilling to change.

Antonio Vaghi says: "I only finally managed to organize the company thanks to my brother's completely different professional experience. He had worked for many years for a big company and was used to team work and organization. I managed the business based on my guts. Stepping down hasn't been easy. There had been some difficult moments: when he made changes I didn't always agree, but I managed not to interfere. My relationship with my brother prevailed: we often fought outside the job, but our family tie always had the upper hand. This changed the company."

During 2004 – 2005 the company first worked with a private equity fund, having sold a minority share of an Austrian company to a fund that bought the whole stock. The processes of the fund to determine the company's value lead the Vaghi brothers, especially Antonio, to think of Tieffe's value and his assets. It is at this moment that the idea of a withdrawal starts to form, due to his mental weariness after forty years spent "on the front line" and to the will of monetizing, fully or partially, his company assets. On the other hand, he also knew that the company still needed his support and that retirement couldn't but take long.

Tieffe organizational structure, in fact, though having an autonomous production, was still heavily relying on his founder for all technical and R&D activities. It was then necessary to form, around Antonio Vaghi, a team that could work starting from his experience to further develop it, in order to allow his retirement.

Gianni Vaghi says: "Now my brother is completely untied from his daily activities, has no time boundaries and the company always knows what to do, regardless of his presence. He loves working at night, he has even created a small lab at home and often works from there. Our American customers are very happy about this, given the different time zones, in fact, they can now talk to him when it's afternoon in the US".

It seemed initially difficult to match the almost "artistic" activity of Antonio Vaghi with the functioning and organization of a technical department, this solution, nonetheless, actually seems to be working and it is starting to produce first results. The young technicians Antonio is training are becoming more and more autonomous and are proving to be able to pursue the funder's ideas and solutions.

The arrival of the private equity fund was en exceptional thrust to the making of a management team around the person of the current CEO, Giovanni Vaghi, for two main reasons, both due to the explicit will of the Fund to finalize the investment in a relatively short time (5 to 8 years). The possibility of a periodical reorganization of the ownership and therefore of the company structure forced its top brass to state their intention for the future and to program careers of the managing team. It has immediately been located, among the managers, the person who will be CEO/general director after Giovanni Vaghi, and who will become part of the company through the stock option plans. This particular tool, stock option, has become, also thanks to the fund and his "way out" needs, very effective to prompt and motivate managers, starting from Giovanni Vaghi, that, with the private equity transaction increased from a 2% to a 7% stock shares.

Giovanni Vaghi himself explains the main idea: "The assumption that the fund will eventually sell its shares made us think of the possible ways out. Key managers could become associates of a new fund that could buy the company. We have now set up a stock option plan to allow the current commercial director and our productive unit in Czech Republic manager to enter into Tieffe stock. This way we mean to encourage results achievement and to strengthen the bond with the company in a far-seeing perspective. As to this, I have already stated that the current commercial director will assume my position as CEO when, in abut ten years, I will retire."

From previous observation, we can infer the fundamental thrust the fund has given to the development of new organizational skills. Having set a deadline within which the person so far having held all key competences will have retired served as a extraordinary incentive for all people involved. Familiar manager meaning to stay within the company must acquire new skills to justify and strengthen their nomination for leadership; non familiar manager, tied to a stock option plan, are on the other hand forced to legitimate their run for the same position toward the organization and to become associates. The organization must thereby acquire all skills so far held by the outing leadership and current owners know their retirement, as well as the value of their assets are closely linked to the actual willingness to communicate and transmit to others their competences and experience.

### 4.6 Private Equity Fund influence on goal and personal interests setting

The intervention of the fund has been promoted by succession uncertainty and misalignment of owner families' members' goals and interests.

The cooperation with the Fund produced changes, not only in the company but also in the people working in it, thus leading to a general shifting of personal interests and goals according to one's position in the company and of the new opportunities brought by the fund.

Assets are a very important aspect to take into consideration when analyzing the fund's effects. Associates and funders Antonio Vaghi and Gennaro Calanchi were able to liquidate a significant part of the assets invested in the company and could thereby deal with the delicate succession issue without putting on the plate their whole wealth.

While the Calanchi family had already stated their disengagement will, Antonio Vaghi couldn't male this decision without also thinking of the company's activities continuance.

Any potential dislocation would have been bound to make him reconsider his retirement plan. Things went actually substantially well. The company passed with flying colors the 2008 and 2009 financial crisis, and 2011 seems to be carrying on the company's previous growing trend. Organizational structure is proving to be efficient even during the funder's absence, as well as the new technical department and R&D that, though still being lead by Antonio Vaghi, are becoming more independent. This propped Antonio Vaghi's decision to leave the business, a decision made official to the fund early in 2011, though including the possibility for Vaghi to fill the role of commercial and technical consultant.

More complex is the position of Giovanni Vaghi, currently having taken over the company from his brother as CEO. The entrance of the fund into company stocks further strengthened his position, given his role in the buyout process and his unique managerial experience that makes him the only one suitable for the role of *liason* with the financial partner. His successful takeover from Antonio reinforced his awareness of the company's potential even without its funder direct contribution and this enhanced his interest in the business. Giovanni Vaghi says: "When I first started working in Tieffe I was looking for an entrepreneurial experience and my brother, in order to help me do it, sold me a 2% stock share. Shareholders sold me another 5% as an award for the successful private equity process. So far I've always invested all my savings in the company, because I strongly believe in the business and I'm not planning on retiring for at least 10 more years. When the fund will sell its shares, if I may, I'm ready to re-invest all profits from the operation into the company to increase my share. I would even consider a possible buy-back if my brother's family agreed to stay".

The same goes for Lara Vaghi. Initially involved in the company with an administrative position, on the occasion of the LBO operation she received from her father a 2% shares and took on the responsibility of company administration and reporting, directly managing the relationship with the fund. The growing de-personalization of the company from its prevailing father figure, along with the gaining of new managerial skills, strengthened her interest in the business. The company, which she initially saw as his father exclusive turf, becomes more and more within her reach, once acknowledged that besides technical aspects, in which she could never have been involved, there also were other important activities she could have easily taken care of, not connected to technology. Lara Vaghi describes her experience as follows: "My father's management was initially so self-centered that even an engineer son could have succeeded. Imagine a daughter with administrative skills like me! In that situation I didn't feel up to his succession. After the fund intervention and thanks to the experience I achieved as chief department, I had the opportunity of getting more involved. I became aware of the multitude of activities necessary to lead a company and I came to know all existing leadership styles, different from my father's one. I don't think my family will be back in the business, but if given the opportunity I would be ready."

Empirical observation so far expounded show how the family experienced the "after funder" phase with the arrival of the Fund, without a finality limit. During a period of changes, introduced in the organization and management by the fund, players involved could change, sometimes even radically, their own interests and goals inside the company. This could lead to a general stakes shifting, therefore the possibility of a new prevailing coalition, possibly even within the family, that could take the baton back from the previous leadership.

### 4.7 Private Equity influence on corporate governance practices

A Private Equity Fund buying a company stock's majority inevitably stresses the separation from ownership and company management. The fund, in fact, doesn't have specific business skills and relies on current entrepreneurs for management strategies, thereby mainly acting as controllers.

The Cape Fund had the same approach with Tieffe, though having bought the 60% of equity, governance structure, in fact, still allowed for the operative management to be run by the Vaghi brothers, while Board of Directors and Board of Statutory Auditors are controlled by the fund. The Board of Directors has 5 members, 3 of which, without operative powers, are nominated by the Cape Fund, while the other 2 are nominated by the Vaghi family, Antonio Vaghi, as President, and Giovanni Vaghi, as CEO. The Board of Statutory Auditors is composed by 3 members, 2 of which, among whom is the President, are nominated by the Fund, and 1 by the other associates.

The economic power still held by the Vaghi family, though the company is legally controlled by the fund, is a well known issue for both sides. As to this, Antonio Vaghi says: "With the entrance of the fund I haven't experienced particular differences, in fact, never having had an absolute majority, I have always been used to stake everything to pursue my ideas. I'm used to pursuing goals with stoutness and perseverance. Besides, it's us managing the company, therefore it's us who know products and hold relationships with customers, our opinion cannot be ignored".

Maurizio Perroni, Tieffe's Director appointed by the private equity firm, shares this position: "When we enter a business, de facto we financially back an entrepreneur in some project of his, we do not buy a company. If the manager is fair and proves to be resolute in pursuing his project, even if we control the company, we ask for permission. It' doesn't matter who owns shares, what matters is who is controlling the business."

Nevertheless Tieffe, as its funder said, had always had a financing member. Gennaro Calanchi, in fact, never really had an operative involvement in the company, though being Chairman and having the same poker as Antonio Vaghi. He regularly visited the company to check accounts and financial aspects, while he shared with Antonio Vaghi decisions on main strategies and investments. There have never been interferences in the management.

On the other hand, Private Equity fund and the investing associate are substantially different: while the first one, as all institutional investors, immediately set a 3 to 5 years time limit to his engagement, the second one never had selling objectives; his association with the Vaghis, in fact, also thanks to the satisfactory balance achieved, has been lasting more than 30 years.

Control systems are also different: though Cape fund, in fact, has always respected the Vaghis' managing independence, administrative controls on Tieffe's pattern are definitely more thorough than those made by Calanchi, as previously outlined.

A first control is made in the governing organs, attending to BOD three – monthly meetings, and verifying Board of Statutory Auditors also three – monthly meetings.

Much more effective than formal meetings are informal ones, weekly or monthly, with one of the administrators nominated by the fund to consult and monitor the company. Maurizio Perroni, in charge of this task along with Marco Bortot says: "These are very informal meetings, in which daily business related issues are discussed with CEOs. For example, we discuss future investments, treasury management, economic situation trends, we meet with banks…in these last two years of financial crisis I think the Fund presence ha been tangible and a mutual trust was built between us and the entrepreneurs."

This activity, combining controlling and consulting services, is matched with frequent phone conversations, even daily ones in critical phases.

Besides visits and formal meetings, the Fund is regularly informed from management control and accounting. The company weekly communicates total pay-off and incoming orders, and three times a month liquid assets and treasury budget for the next twelve months. The company monthly draws a management budget, to be discussed with others about internal working fares, warehouse, profitability configurations (gross margin, ebitda, ebit). Also montlhy, the company provides a series of indicators about internal efficiency control, for example cost per kilogram of raw materials.

CEO Giovanni Vaghi explains: "When the private equity firm bought the majority of Tieffe we already had a well developed information system, the Fund, in fact, didn't need to use a new CFO. Besides, we already produced for ourselves all information requested, so when we started providing regular reports, the fund's administrator just had to pick the most suitable for their needs."

Our observations show how the private equity buyout significantly modified the managing structure, that went from being mere formal legal entities, to real consulting and strategies' defining tools. The new professionalisms of the BOD, non operative ones but constantly in touch with CEOs, allowed the whole organization to acquire new finance and control related skills. This is obvious in Tieffe too, even though the company wasn't completely de-structured even before the arrival of the fund: ownership was, in fact, composed by operative and financing associates and had advanced information system, besides an official organizational structure.

## 5 Analysis and discussion

This paper extends previous literature by providing evidence on the topic of the family business exit. To date, little research has been devoted to improving knowledge on the role business exit may take in entrepreneurial family firms (Habbershon and Pistrui, 2002). Recent literature indicates that exit may stem from failure as well as success, but research should devote more effort to focusing on which specific route is employed (Wennberg, Wiklund, DeTienne and Cardon, 2010).

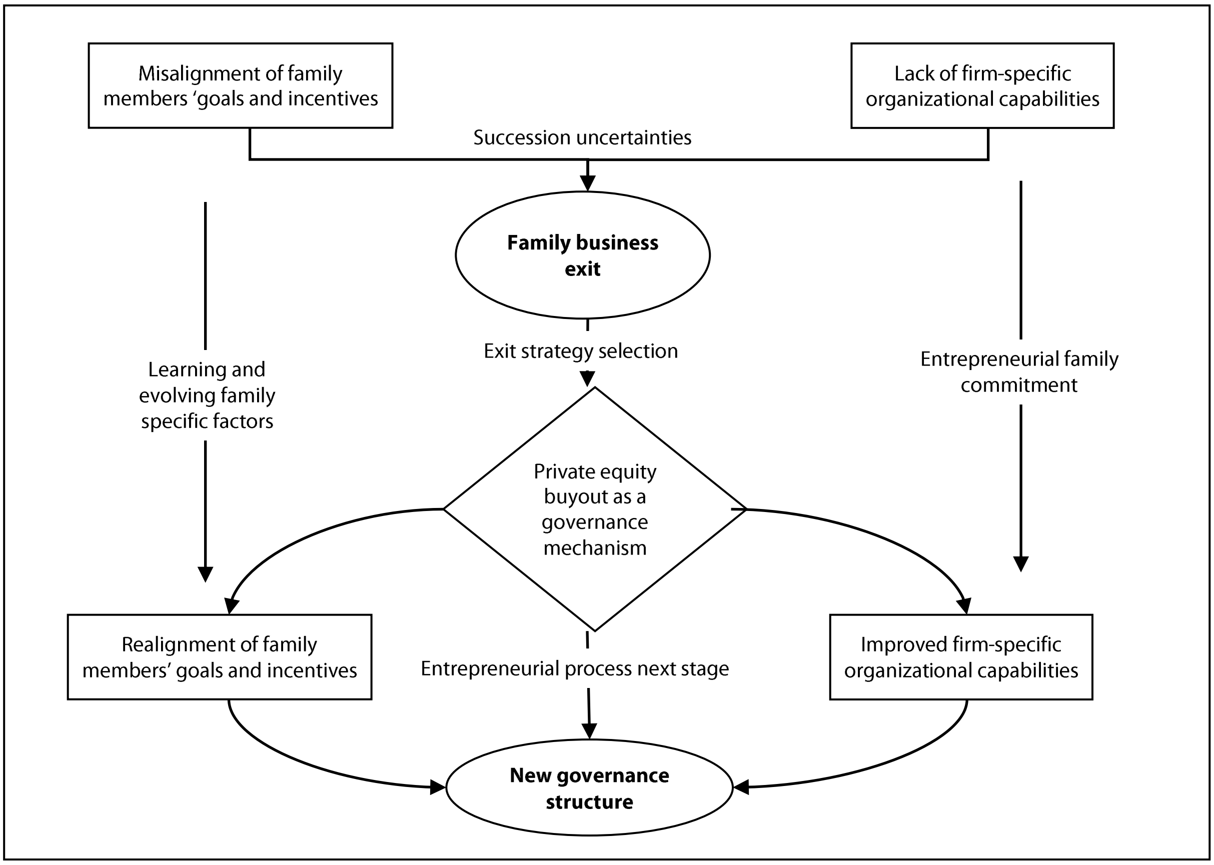
Considering both the family and the firm level, we investigated factors leading to the exit decision. Moreover, our research also covered the exit strategy, aiming at understanding the effectiveness of the private equity buyout as a governance mechanism by which the resulting transition was carried out (Dawson, 2011; Scholes, Wright, Westhead and Bruining, 2010; Wright, Amess, Weir and Girma, 2009; Wright, Hoskisson and Busenitz, 2001). This approach is consistent with recent advances in entrepreneurship research addressing the exit as a stage of an entrepreneurial process (DeTienne, 2010; Wennberg, Wiklund, DeTienne and Cardon, 2010). Thus, our research responds to recent claims for extending knowledge on the role of families and family firms in entrepreneurial processes (Chirico and Nordqvist 2010; Dyer and Handler 1994; Kellermanns, Eddleston, Barnett and Pearson 2008; Nordqvist and Melin, 2010; Rogoff and Heck, 2003; Salvato, Chirico and Sharma, 2010). This paper also contributes to value creation perspectives on corporate governance, addressing its enterprise dimension and emphasizing the need to improve our understanding of the role of corporate governance practices for sustaining or obstructing strategic transitions in entrepreneurial firms (Filatotchev, 2007; Filatotchev and Toms, 2003; Filatotchev, Toms and Wright, 2006; Gedajlovic, Lubatkin, and Schulze, 2004; Zahra and Filatotchev, 2004). With this in view, our paper provides new evidence on the role of private equity transaction as a moderator of strategic transitions in family firms. In figure 2 we propose a model of the entrepreneurial exit in family firms by the bridging role of a private equity transaction.

Specifically, our research provides three main theoretical contributions.

A first insight lies in the role of organizational capabilities as a contingency influencing the exit within the entrepreneurial process. When succession uncertainties arose in 2005, Tieffe was carrying out a transformation process of its resource base. The organizational change was managed by the founder's brother with the aim of improving organizational capabilities and reducing Tieffe's dependence on its founder. However, at that time family members involved in the running of the business agreed that the most valuable resource was the entrepreneur's acclaimed capacity in designing new products. Tieffe needed a period of time for transforming the entrepreneur's capacity into an organizational capability by learning, experiencing and establishing R&D processes. To this end, Giovanni Vaghi said: "I usually say that Tieffe is a rear-wheel drive, because our success relies upon the distinctive value of our products. Their well recognized quality and innovativeness are our most effective marketing effort".

Therefore, despite the existence of family members with a potential to succeed, the lack of firm-specific organizational capabilities for successfully facing with strategic challenges led to the family business exit. Accordingly, a provision in the private equity buyout agreement required the entrepreneurial family commitment in the business for the following years up to the next ownership change and ensured their strategic and managerial leadership. In the private equity firm view, the entrepreneurial family was the driver for exploiting the firm's value with the aim of taking advantage of the next ownership change. Even though previous research recognizes that the firm's organizational structure may imprint the firm, hence influencing the entrepreneurial exit (DeTienne, 2010), inadequate attention has been devoted to how organizational capabilities may impact the exit decision and the effectiveness of the following transition. Furthermore, our findings are consistent with previous research addressing capabilities as facilitators of trans-generational value creation in family firms as well as for dealing with new strategic dynamics in entrepreneurial firms (Chirico and Nordqvist, 2010; Zahra and Filatotchev, 2004).

**Figure 2.** The model




Specific family members' characteristics were also relevant when shaping the exit decision and the ownership transition. When struggling with the generational succession issue, not only the founder-entrepreneur, but also two members of the entrepreneurial family were actively involved in the running of the business. They had the potential to succeed because they were interested, as they currently are, in maintaining their commitment in the family business. The founder's daughter in those years did not hold a position of responsibility, but the founder's brother had matured 12 years experience in managing the firm as a Director and he was also the leading actor of the organizational restructuring. Differing goals, career expectations, and incentives characterized each member of the entrepreneurial family as well as differing time horizons conditioning individual concerns. The family emerged as an entrepreneurial team balancing incentives, goals and attitude of its individual members which resulted in the family firm's entrepreneurial behaviour (Aldrich and Cliff, 2003; Kellermanns, Eddleston, Barnett, and Pearson, 2008; Sharma and Manikutty, 2005). Multiple generations involvement have been identified as a source for fostering the family business enterprise together with modifying ways of doing things (Eddleston and Kellermanns, 2007; Kepner, 1991; Litz and Kleysen, 2001; Salvato, 2004). Thus, because of their family ties, the entrepreneurial family engaged in finding an exit option suitable for overcoming divergences and balancing both family and perceived requirements of the firm. In this way, options such as selling the company or entering in vertically integrated groups were rejected because they would reduce the family strategic involvement in the business. Therefore, a further insight of this paper is that family-specific attitudes, as in this case was the intention of balancing the interests and goals misalignment inside the entrepreneurial family may affect the entrepreneurial process, hence leading to the exit decision. Moreover, unique family characteristics will impact the entrepreneurial family capacity of selecting the effective exit route. In a corporate governance perspective, goal and interests alignment acted as a governance practice substituting alternative formal control mechanism, such as board of directors.

A final, but central contribution of this paper refers to the bridging role of the private equity buyout in the entrepreneurial process of a family firm. Literature well recognize private equity buyout as a governance mechanism which may enable efficiency improvements or which may foster entrepreneurship by providing external resources (Cumming, Siegel and Wright, 2007; Dawson, 2010; Scholes, Wright, Westhead and Bruining, 2010Wright, Amess, Weir and Girma, 2009; Wright, Hoskisson, Busenitz and Dial, 2000). In the case we studied, a differing role exerted by the private equity buyback emerged as crucial if considering the exit in the context of the entrepreneurial process of a family firm. We addressed it as a bridging role which refers to providing a temporary governance structure which enables a transformation of the firm's resource base along with required changes inside the entrepreneurial family. The private equity buyout, by stabilizing the ownership structure, enabled the entrepreneurial family to address suitable solutions to the issues which previously led to the exit decision. The entrepreneur's brother could carry on the development of organizational capabilities and especially R&D capabilities because of their crucial role. This task was recently perceived as reached when employees from the R&D function were able to solve a critical technical problem affecting a new product. After years of work-shadowing with the founder-entrepreneur, Tieffe is currently able to design new products and to deal with technical concerns previously managed by the founder-entrepreneur.

Furthermore, family related issues overcame uncertainties and evolved into appropriate solutions. Antonio Vaghi, interested in his retirement and in his own family wealth protection through the private equity transaction, took advantage of the firm's value by selling a main share of his equity. Currently he owns 16% shares and he serves as the Board Chairman. He is not involved in the running of the business, but provides consultancy for R&D activities. On the other hand, his brother was interested in maintaining the family involvement in the business and also in extending his role. Through the private equity transaction he was appointed as CEO and increased his shares to 7%. In this way, as well as by the firm's improved organizational capabilities, Tieffe's entrepreneurial leadership could shift from technical into managerial competences, hence providing a new option for the next ownership change. In fact, the bridging role of the private equity buyout matured conditions for a family buyback, overcoming succession uncertainties. Then, according to the buyout agreement, if Tieffe reaches its mid term expected goals and performance, Gianni Vaghi will also have the opportunity to take advantage of the further increase of the firm's equity value. Finally, Lara Vaghi over the last few years gained managerial competences and increased her responsibilities, taking charge of accounting and finance. She then matured her interest in the family business continuity and her awareness of her potential role in the firm increased Lara Vaghi said: "When we were faced with succession issues, I feared taking charge of high responsibilities because I have neither a technical nor commercial background. I only managed administrative tasks and couldn't imagine the firm's future without my father and so I agreed to the exit decision. Over the last years I have improved my competences and my role, also being involved in relationships with the private equity firm. Therefore, today I'm interested in managing the family business and my view about succession and exit has changed".

In this way, the private equity buyback sustained the firm's growth and its value creation strategies neither by cutting costs nor by providing external resources, but by enabling the entrepreneurial family to exploit internal resources. Accordingly, corporate governance practices post buyback ensured a high level of accountability, but let the entrepreneurial family exert its strategic leadership with discretion.

## 6 Concluding remarks

This study attempted to investigate factors influencing the exit as a stage of the entrepreneurial process in the context of a family firm and how a private equity buyout may represent a corporate governance mechanism ensuring the firm's growth and value creation strategies. It analyzed the case of Tieffe, an Italian firm which, faced with succession uncertainties, carried out the exit decision while maintaining its involvement in the business. Its experience represents an interesting example showing how corporate governance practices may affect the entrepreneurial process favouring or obstructing a firm's survival. It also evidences the close link between the exit decision and the exit route, identifying previously neglected topics in entrepreneurship and family business research. We also shed light on relevant relationships between corporate governance mechanisms and entrepreneurial challenges which are supported by our case data, subsequently addressing a process view to deal with the investigated topic.

Our study aims to develop knowledge at the intersection of corporate governance and entrepreneurship research, considering the role of family specificities. This stream of research promises to advance knowledge in a contextual approach to corporate governance, but it also has implications for an appropriate design of corporate governance practices in family firms.

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