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Measures of Value in Acquisitions: Family Versus Nonfamily Firms

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Abstract

This article sheds light on the valuation of family firms when compared with nonfamily firms as acquisition targets. The authors argue that although the majority of theoretical and empirical research explicitly recognizes the prevalence and superior performance of family firms around the world, acquiring companies tend to regard family firms as unprofessional and inefficient organizations, thus negatively affecting their valuation when compared with nonfamily firm targets. Overall, the authors' empirical analysis, based on a matched-pairs methodology and use of multiples, shows that acquiring companies favor the stagnation perspective rather than the stewardship perspective and thus pay less (i.e., acquire at a discount) for a family firm target than for a nonfamily firm target.

Keywords

acquisition, family firms' valuation, acquirers' perception, matched-pairs methodology, EBIT and EBITDA multiples

The increasingly rapid change in the current business environment and the need for novel solutions often motivate firms to expand their resources through acquisitions (Makri, Hitt, & Lane, 2010). Acquisition is a unique form of entrepreneurship activity through which a company (acquirer) acquires another company (target; Harrison, Hitt, Hoskisson, & Ireland, 1991). In the latter half of the 20th century, acquisitions became a prominent strategy for many companies, large and small, to acquire complementary resources. Their strategic use to acquire new resources has become a well-institutionalized corporate phenomenon, primarily because acquisition targets provide opportunities for organizational learning by exposing the acquirer to new and diverse ideas, thereby overcoming resource-based constraints to growth (Harrison et al., 1991; Hitt, Hoskisson, & Ireland, 1990).

However, whereas acquisition has received considerable research attention in the strategic management literature (e.g., Harrison et al., 1991), and although family firms are the most common form of organizations throughout the world, accounting for more than 75% of all registered companies in most economies (Miller, Steier, & Le Breton-Miller, 2003), only few recent studies have focused on family firms' acquisitions (e.g., Feito-Ruiz & Menéndez-Requejo, 2010; Holmen & Nivorozhkin, 2007; Mickelson & Worley, 2003; Steen & Welch, 2006). A family firm is defined here as an organization in which a family has a substantial ownership stake and has at least two of its members in key management positions (see Miller, Le Breton-Miller, Lester, & Cannella, 2007; Westhead & Cowling, 1998).

A central issue in any acquisition is the valuation of the target company by the acquirer—a procedure to determine the price to be paid for the acquisition. Surprisingly, none of the aforementioned family firm studies compared valuation of privately held family firm targets with nonfamily firm targets. Our empirical research attempts to fill this gap in the family firm literature, thus suggesting important implications for research and practice. Two major views have been constructed regarding the nature of family firms: stewardship and stagnation

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(Miller, Le Breton-Miller, & Scholnick, 2008). The stewardship perspective suggests that family members view themselves as stewards of the family firm and thus nurture it for the support of future generations through stewardship over the continuity of business, employees, and customer relationships. This enables family firms to perform better than nonfamily firms. Alternatively, the stagnation perspective proposes that family organizations face unique challenges to growth and expansion mainly because of resource restrictions. Miller et al.'s (2008) findings fully substantiate the stewardship perspective but not the stagnation perspective (see also Anderson & Reeb, 2003).

Building on the aforementioned arguments, we argue that although most theoretical and empirical research explicitly recognizes the prevalence and superior performance of family firms around the world (Anderson & Reeb, 2003; Miller et al., 2008; Sharma, 2004), acquirers tend to regard the family firm as an unprofessional and inefficient organization in which decision-making processes are driven by emotions rather than by economic rationality (Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson, & Moyano-Fuentes, 2007; Salvato, Chirico, & Sharma, 2010). Hence, acquirers are disposed to pay a lower price (i.e., acquire at a discount) for a family firm target than for a nonfamily firm target. We believe that a focus on family firms may both advance knowledge on the valuation of target firms and help us understand specifically *why* acquiring companies pay a discount price for family firm targets when compared with nonfamily firm targets.

The potential insights that can be gained by addressing valuation issues in acquisitions from a family perspective result from the unique and distinguished features of family firms when compared with nonfamily firms. The family firm is indeed the only organization in which family members are simultaneously active in the family and the business, hence significantly influencing business performance (Arregle, Hitt, Sirmon, & Very, 2007; Chirico & Salvato, 2008). Thus, tangible and intangible resources are unique in this type of organization since they result from interactions between the family, its individual members, and the business (Sirmon & Hitt, 2003). Consequently, when the target company is a family firm whose economic value stems not only from the business but also from the family, evaluating such a firm can become quite complex. A detailed examination from both the family and business' aspects is therefore required at the time of acquisition. However, acquirers generally tend to focus their attention on the negative aspects of a family firm. In their eyes, stagnation drawbacks prevail over stewardship advantages, thus underestimating its real value.

We explore the overlooked topic of valuing family firms within the context of acquisition, using a unique data set of privately held family and nonfamily firm targets. Given that the valuation of both privately held family and nonfamily firms is a difficult and often highly subjective process, especially because a privately held company has no observable stock price to serve as an objective measure of market value, we relied on valuations from recent acquisitions. We employed a matched-pairs method for statistical analysis and the standard technique of multiples as measures of value (see Allouche, Amann, Jaussaud, & Kurashina, 2008; Koeplin, Sarin, & Shapiro, 2000). We note the absence of multiples in previous family firm literature. Accordingly, we offer practical implications for potential family firm targets as well as their acquirers.

This article is organized in the following manner. We first review the literature on resource-based logic in acquisitions. We then discuss the advantages and disadvantages of the family firm and explore how it is perceived by external investors in the acquisition process. Accordingly, we develop our hypothesis followed by a description of the methodology. The article ends with the results, discussion, contributions, and limitations of the study. Implications for research and practice are shared in the concluding section.

Resource-Based Logic in Acquisitions

The resource-based view of the firm is a useful framework for studying the sources of value creation (Sirmon, Hitt, & Ireland, 2007). The essence of resource-based logic rests in an emphasis on bundles of unique tangible and intangible resources at the firm's disposal as the foundation for creating value and competitive advantages (Barney, 1991). The common factor driving acquisition strategies is that in dynamic markets with increased globalization, it is hard for a single firm to possess all resources needed to develop and sustain current competitive advantages. Thus, most organizations rely on other organizations to help support growth objectives (Harrison et al., 1991). Furthermore, the complexity of modern products and services, and the changing consumer demands, increase interdependence among organizations and amplify the need to recombine resources (Sirmon et al., 2007). In this instance, no other combination of firms can produce the same value, meaning that the synergy is the source of a competitive advantage (Makri et al., 2010). Novel resources that a firm cannot create independently are thus developed and new markets are entered through acquisitions. Accordingly, Hitt et al. (1990) argue that acquisitions may serve as a substitute for innovation. For example, firms may acquire target companies with technology different from their own so as to acquire new product lines without assuming high risks involved in internal innovation (Harrison et al., 1991; Hitt, Harrison, & Ireland, 2001).

In sum, firms acquire companies characterized by resources that they themselves lack, such as management teams with specialized knowledge in a specific area or market. Thus, it becomes extremely important to thoroughly evaluate the tangible and intangible resources available in the potential target company so as to determine its economic value and the price to be paid for its acquisition (see Fernández, 2002; Koeplin et al., 2000). In the subsequent sections, we argue that the valuation issue can be specifically complex when the target company is a family firm whose economic value stems from both the family and business' sides (e.g., family members' idiosyncratic knowledge). Accordingly, we first present the family firm as a repository of valuable tangible and intangible resources that can be exploited by external investors through acquisition strategies (Arregle et al., 2007; Miller et al., 2008; Sirmon & Hitt, 2003). Then, we describe how acquirers' perception of a family firm target may strongly affect their valuation when compared with a nonfamily firm target's valuation.

The Family Firm

Stewardship Versus Stagnation Perspectives

That family firms play a dominant and crucial role in today's economy is now well documented (Colli, 2003). Family firms are depicted as emotionally committed organizations characterized by intense interactions among family members within the family and the business. Emotional attachment and rational judgment are inseparably intertwined, thereby significantly affecting the strategic decision-making processes (Sirmon & Hitt, 2003). The essential qualities of family firms result in equally distinctive organizational behaviors and outcomes in which "the interaction of two social systems—the family and the business—enables family members to act simultaneously within the family and the business" in their personal and professional lives (Chirico & Salvato, 2008, p. 173). Miller et al. (2008) found that the family firm is, in many respects, an especially salutary organizational form, repository of valuable resources, and conducive to corporate longevity when compared with a nonfamily firm (see also Anderson & Reeb, 2003).

Two major views have been constructed regarding the nature of family firms: stagnation and stewardship (Miller et al., 2008). The stewardship theory considers the family to be a source of competitive advantage whose uniqueness derives from the integration of family and business. In family firms, both family member owners and managers view themselves as stewards of the family firm; their motives are aligned with the objectives of the organization, which must be nurtured to support the future generations (Corbetta & Salvato, 2004). Family members are altruistically dedicated to the business and tend to place the business's objectives ahead of their own. Such an altruistic behavior helps strengthen family relations by reducing relationship conflicts and fostering trust, interdependence, and commitment to the family's long-term success (Corbetta & Salvato, 2004). Miller et al. (2008) delineate the following three forms of stewardship in family firms:

- *Stewardship over the continuity of business*: It reflects family members' strong emotional attachment to the organization (Gómez-Mejía et al., 2007; Stockmans, Lybaert, & Voordeckers, 2010), which contributes to an extraordinary commitment to proactively search for innovative strategies and exercise stewardship over the well-being and continuity of the firm in the long run (Miller & Le Breton-Miller, 2005; Miller et al., 2008; Salvato et al., 2010). Stewardship over the continuity leads family firms to invest more in product research, market share, and reputation developments when compared with nonfamily firms.
- *Stewardship over employees*: It indicates the special care for the family firm and its continuity resulting from building "a group of talented, motivated and loyal employees" to guarantee family's prosperity over time (Miller et al., 2008, p. 55). To this end, intensive training programs

are developed to coach employees to do their job well, foster the development of new products, and acquire new knowledge (Chirico, 2008).
- *Stewardship over customer relationships:* It suggests that family firms are interested in "building enduring networks and associations with clients and other suppliers of valuable resources" (Miller et al., 2008, p. 56). This motivates family firms to be closer to their customers, to improve the exchange of information with them, and to consolidate their family trademark by directing more effort into marketing activities such as telemarketing and trade shows (Miller & Le Breton-Miller, 2005).

On the contrary, stagnation perspective depicts family firms as organizations facing the challenge of being undercapitalized and subject to conservatism and characterized by slow-growing performance and short life span (Miller et al., 2008; Morck & Yeung, 2003). Lack of financial capital often leads to deficiency of other resources such as skilled employees. Parents may act altruistically toward their children, thereby hiring them despite incompetency. Thus, talented nonfamily managers may have an aversion to work in family organizations when more prestigious working positions are often reserved for family members (Vinton, 1998). Consequently, knowledge heterogeneity to promote novel and creative ideas is substantially reduced (Chirico & Salvato, 2008). Resource constraints may also lead to conservatism and induce family members to avoid crucial strategic decisions to maintain family security. As a result, such organizations may develop cultures that make them inflexible, resistant to change, and inclined to stick to path-dependent traditions that limit growth of the firm (Chirico & Nordqvist, 2010; Dyer, 1986). Some authors explicitly refer to a "generational shadow"—an enduring effect of previous strategic paths and practices on a family firm's subsequent evolution (Davis & Harveston, 1999).

It is worthy to note and underline that Miller et al. (2008) find support for the stewardship view and no confirmation whatsoever for the stagnation view, suggesting that "the family firm form is in many respects an especially vibrant one" (p. 73). Also, Anderson and Reeb (2003) conclude that a long-term focus gives family companies a leg up over nonfamily rivals.

In the subsequent sections, we will argue and empirically demonstrate that acquirers attribute a lower valuation to a family firm target when compared with a nonfamily firm target, primarily because they perceive the family firm as an unprofessional organization in which stagnation motives prevail over stewardship motives.

Valuing Family Versus Nonfamily Firms in the Acquisitions Context

The valuation of a target company is relevant to determine the price to be paid for its acquisition. Based on this value, the acquirer will acquire at a premium (i.e., price for a target firm > average price paid for comparable companies) or discount (price for a target firm < average price paid for comparable companies) (Koeplin et al., 2000). There are multiple approaches to company valuation, such as cash flow discounting methods, income statement–based methods, as well as rarely used balance sheet–based and goodwill-based methods (Benninga & Sarig, 1997; Fernández, 2002).

Building on our previous arguments, a growing body of research suggests that family firms outperform nonfamily firms (see Anderson & Reeb, 2003; Miller et al., 2008; Sharma, 2004) on a number of important indices such as market capitalization, return on assets, return on equity, as well as normalized compound returns (Allouche et al., 2008; Robertson, 2007). For instance, Castillo and Wakefield (2006) reported higher levels of company's cash balance and return on investment for family firms than for nonfamily firms.

Most previous studies have regarded family firms as solid and valuable organizational forms whose resources have been carefully built by family members across generations. Indeed, given that family firms are long-term oriented, family members in key management positions are induced by their strong commitment, collectivistic value, collective identity and sense of trust, and altruism to actively intermingle business and family resources to guarantee the continuity of their business with a reduced recourse to debt (Sirmon & Hitt, 2003). To support their collective identity based on a collectivistic culture, in which each member views himself as part of "a larger (family or social) group [focusing on 'we'], rather than as an isolated independent being [focusing on 'I']" (VandenBos, 2007, p. 195), family members commit to the success of their business. They are well-disposed toward investing "patient financial capital" (Sirmon & Hitt, 2003), they go beyond the call of duty, and exert extra efforts on behalf of their organization. For instance, family members are prone to make the necessary personal sacrifices and supply extra capital in the form of additional working hours, lower salary, free labor, and use of personal savings to keep the business healthy across generations (i.e., survivability capital; Sirmon & Hitt, 2003). Moreover, they invest greater resources in employee trainings, customer relationships, and research and development of new offerings; they give more attention to boosting the reputation of the business and put more emphasis on broadening the market and the share of the market (Miller et al., 2005; Miller et al., 2008).

Interestingly, in a note to its clients in September 2007, Credit Suisse, one of the world's biggest investment banks from Switzerland, recommended that investors consider taking long-term positions in companies with a significant family management influence because of their superior performance. Credit Suisse publicly announced that the firms in its family index had outperformed their sectors by an average of 8% in 2007, with a similar trend since the start of their research in 1996 (Robertson, 2007).

Hence, an acquiring company whose goal is to have access to valuable complementary resources should positively value a potential family firm target's resources, which are carefully built by family members across generations. Certainly, when skilled family members—repository of knowledge—are retained in the acquiring company, then stewardship advantages in terms of family members' values, devotion toward the business, human capital, and enduring customer relationships persist after acquisition, thus making the family firm a genuinely valuable organizational form to be acquired. To this end, it becomes essential to retain at least some of the family members who represent repositories of specific tacit knowledge resources that may be difficult to imitate or acquire elsewhere (Hitt et al., 2001). For instance, based on a sample of 147 acquisitions, Krishnan, Miller, and Judge (1997) empirically found that the lower the turnover among the acquired firm top management team the better the postacquisition performance. They conclude that "the acquisition process is most successful when organizational learning occurs. . . . Furthermore, it appears that a crucial aspect of organizational learning is the blending of top management teams, rather than emasculation of one or both teams" (p. 371).

There are basically two views that acquirers could adopt with respect to family firm targets: the stagnation perspective and the stewardship perspective. Nevertheless, the term *family firm* is commonly and too often associated with concepts such as small unprofessional business (Gumpert & Boyd, 1984), autocratic business (Dyer, 1986), founder's shadow (Davis & Harveston, 1999), nepotism (Vinton, 1998), and paternalism and family inertia (Chirico & Nordqvist, 2010). Indeed, a common belief is that family firms are inefficient firms, sometimes perceived as "old-fashioned" and boring (Buckley, 2006). They are depicted as more conservative than their nonfamily peers by operating at lower levels of innovation (Gómez-Mejía et al., 2007; Morck & Yeung, 2003). Accordingly, in the eyes of acquirers, the stagnation view seems to prevail over the stewardship perspective. In support of this line of thought, Dawson (2009) found that external investors positively value family firms only when nonfamily managers are also involved in the management of the company. Nonfamily managers improve the perceived quality of the family firm's human capital by being associated with a certain level of professionalism and by showing a certain degree of family members' willingness to delegate authority and be open to outsiders. Moreover, external investors perceive nonfamily managers to be as professional as themselves (Dawson, 2009). The aforementioned arguments suggest the propensity of external parties to look at a family firm as an unprofessional and low-performing organization. Such negative perception is mitigated only when nonfamily members—perceived to be more professional—are active in management.

To sum up, while the family firm is a valuable organizational form, and although most family firms' advantages persist after acquisition if some of the family members are retained in the acquiring company (e.g., valuable resources carefully built over generations by committed family members; family members' devotion toward the business, human capital; customer relationships), picturing the family firm as an unprofessional and inefficient form of organization drives the acquiring company to underestimate the family firm's real value and pay less (i.e., acquire at a discount) for it when compared with a nonfamily firm. In other words, negative family factors, based on stagnation, prevail over positive ones, based on stewardship, and thus the acquiring company attributes a lower valuation to a family firm target when compared with a nonfamily firm target. The underlying assumption is that financial markets are inefficient (Shleifer & Vishny, 2003). Acquirers do not properly analyze the advantages of potential family firm targets and are disposed to pay a lower price for their acquisition. Also, family firm targets have a weaker bargaining position when compared with nonfamily firm targets because of the general and common external investors' perception that family firms are unprofessional organizations. Thus, they are inclined to trade at a discount. These arguments lead us to the following hypothesis:

Hypothesis 1: Acquirers favor the stagnation perspective rather than the stewardship perspective and thus pay less (i.e., acquire at a discount) for a family firm target than for a nonfamily firm target.

Method

Data Collection

To collect the data for our study, we first identified all acquisitions of medium-large privately held companies belonging to the Food & Drink industry in Western Europe, on the Mergermarket database between 2000 and mid-2008, for which the necessary historical financial data were available. Privately held companies are owned by a relatively limited number of shareholders and are not traded on a public stock exchange. Our privately held company data set includes both family and nonfamily firms. Whereas the former have families as major owners, the latter are organized as cooperatives (a common organization structure for the Food & Drink industry), held by individual entrepreneurs, private equity, and other non–publicly listed owners.

Some relevant information regarding our data set is provided here. First, the choice of the Food & Drink industry was motivated by the following reasons. The Food & Drink industry has an intense consolidation activity to supply enough observations (i.e., acquisitions). The Food & Drink industry has also been found to include a large number of family firms, thus facilitating data collection (see, e.g., Miller et al., 2007; Villalonga & Amit, 2006). Moreover, focusing our attention on a single industry enabled us to neutralize the effect of industry on our final results. Second, most previous research on family firms' performance has focused on publicly listed firms, although the majority of companies worldwide are actually in private hands. Our study instead analyzed privately held companies, thus focusing on the under-studied segment of privately held family firms involved in acquisitions. This also allowed us to avoid differences in valuation between privately held and publicly listed companies (i.e., liquidity discount) (Benninga & Sarig, 1997; Koeplin et al., 2000). Third, we omitted all acquisitions in which the target was a missing data for the enterprise value because this would have prevented us from calculating any of the necessary measures. Furthermore, we excluded all targets with negative operating profits[1] (Damodaran, 2006; Liu, Nissim, & Thomas, 2002).

As mentioned before, a more conservative and accurate definition of family firm assumes the family to have a substantial ownership stake (51% or more of equity owned by the family) and at least two of its members in key management positions (Miller et al., 2007; Westhead & Cowling, 1998). A family firm target was defined as such in our data set if the two aforementioned conditions were satisfied. In particular, at least 51% ownership stake was in the hands of the family and at least two family managers were involved in the business before the acquisition. Finally, to maintain to some extent a certain degree of family influence after the transaction, we tried our best to focus our attention on those acquisitions in which one or more family members were retained in the firm after the acquisition, thus continuing an active role in the management of the company. This is especially relevant in the Food & Drink industry where most of the product-making knowledge is tacit and resides in individuals (Makri et al., 2010).

These selection criteria resulted in a data set of 73 pairs of family and nonfamily firms. The sample size is comparable with previous acquisition studies based on the matched-pairs methodology (see, e.g., Hotchkiss & Mooradian, 1998; Koeplin et al., 2000). Specifically in our study, 59 acquirers positively answered our question of whether or not they retained one or more family members in the company after the acquisition. The remaining 14 acquirers preferred either not to answer at all or explicitly indicated that the company was not authorized to disclose confidential information. Recognizing these differences, we ran the analysis first with all 73 pairs of companies, then with the reduced data set of 59 pairs of companies, and finally with a sub–data set including only the companies in which at least two family members were retained in the new company. The latter is obviously the case in which family firms' characteristics are more persistent after acquisition based on the stewardship perspective. Observing that results from the full data set did not change significantly from that of the restricted data sets, we finally

Table 1. Country of Origin of Targets and Acquirers

	Family		Nonfamily	
Country	Target	Acquirer	Target	Acquirer
Americas	N/A	3	N/A	4
BeNeLux	7	8	3	3
France	8	6	13	8
Germany	2	2	1	0
Italy	10	4	6	3
Spain	8	9	9	11
United Kingdom	26	24	29	27
Nordic countries	8	8	6	7
Others	4	9	6	9
Unknown	0	0	0	1

used the full data set of 73 pairs of companies for our analysis.

Given that most family firms are privately held and usually not obliged to disclose private information, it is extremely difficult to obtain reliable financial information on family organizations. The data set used in this study represents a "unique" collection of data, having family firms as target companies and financial information regarding their valuation at the time of acquisition. Table 1 depicts the country of origin of targets and acquirers. Thirty-six percent of family firm targets and 40% of nonfamily firm targets are from the United Kingdom. The prevalence of the deals coming from this country can be explained by the higher propensity of UK companies to disclose financial data (Arruñada, 2008).

Matched-Pairs Approach

We adopted a matched-pairs research design in our study, which allowed us to systematically compare family and nonfamily firms with a similar profile (Allouche et al., 2008; Westhead & Cowling, 1998). This method has already been used in previous mergers and acquisitions studies (Hotchkiss & Mooradian, 1998; Koeplin et al., 2000) and in family firm studies (Allouche et al., 2008; Miller et al., 2007).

We established pairs of businesses (one family, one nonfamily) operating in the Food & Drink industry that matched in their size (in terms of sales and assets), geographical area, year of acquisition, and products. Specifically, to confirm that the effect of size was neutralized (see Allouche et al., 2008; Koeplin et al., 2000), we performed a *t*-test analysis, which, as expected, reported no significant differences between family and nonfamily firms in terms of sales (family firms: mean 123.88, median 47.18; nonfamily firms: mean 190.34, median 65.35; *ns*). Also, a nonsignificant result was obtained for assets (family firms: mean 114.00, median 29.75; nonfamily firms: mean 162.15, median 31.56; *ns*).

Multiples

Multiples have been used as measures of value in this study. Penman (2004) defines multiple as the ratio of a market price variable (such as the stock price, the market capitalization, or the whole enterprise value) to a particular value driver (such as earnings, revenues, or the work force) of a firm. Enterprise value is defined as the value of the target company as a whole. It is calculated by adding together the implied equity value and the net debt of the target company[2] (Mergermarket, 2009). Multiples are considered to be a standard technique employed by investment professionals. Indeed, 90% of equity research valuations and 50% of acquisition valuations use some combination of multiples and comparable companies (Damodaran, 2002; Koeplin et al., 2000). In particular, multiples have been shown to result in the most accurate valuations when the companies are chosen on the basis of industry (Alford, 1992) as we have done in the present research. Multiples prove especially important for the valuation of relatively stable sectors such as the Food & Drink industry (Demirakos, Strong, & Walker, 2004).

To compare the mean of multiples between matched pairs of companies, the *t*-test procedure was adopted (see Allouche et al., 2008; Koeplin et al., 2000; Westhead & Cowling, 1998). The multiples approach has been described by Damodaran (2006) in the following way. First, comparable assets that are priced by the market are found (i.e., acquisitions of comparable companies). Second, enterprise values that emerge from the market prices are scaled to a common variable to generate standardized prices for comparability (i.e., the enterprise value is divided by a relevant accounting measure). Third, standardized values are adjusted for differences across companies (e.g., industry, size, country, year, etc.).

EBIT and EBITDA Multiples

Despite the extensive use of multiples in valuation, there is no consensus on the use of any particular multiple

(Lie & Lie, 2002). In our study, we specifically used two multiples that are often applied in mergers and acquisitions analysis: EBIT multiple (i.e., Enterprise Value/EBIT) and EBIDTA multiple (i.e., Enterprise Value/EBIDTA) (see, e.g., Hotchkiss & Mooradian, 1998; Koeplin et al., 2000). In fact, when the acquisition involves the whole business (vs. just the equity in the business), it is recommended that we examine the value of the firm as a multiple of the EBIT and/or the EBITDA (Damodaran, 2006). They are two valuable measures of a firm's cash flow, based on two different measures of earnings: earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation, and amortization of intangibles (EBITDA). These two measures were selected rather than after-tax earnings because the values of EBIT and EBITDA are both independent of the capital structures (i.e., the mix of debt and equity) of the acquired companies. In contrast, the earnings (i.e., profits after tax) figure reflects the capital structure of the company because earnings are computed after interest expenses and taxes. Hence, two companies with identical profit streams may have different net earnings ratios because of differences in their capital structures. Thus, it is more appropriate to use a multiple based on earnings before interest and taxes to compensate for the differing capital structures of the two firms. Both EBIT and EBITDA provide a measure of company cash flows available to service debt and pay dividends. The difference between the two is that EBIT is computed net of depreciation, which is a noncash expense, whereas EBITDA adds back depreciation (Damodaran, 2006; Koeplin et al., 2000).

Additionally, EBIDTA is the most frequently used multiple and is considered the most appropriate measure to value a company. Indeed, it is often used in company reports and brokers' calculations in both Europe and the United States. For instance, Kim and Ritter (1999) used several multiples for the valuation of initial public offering of matching companies (i.e., P/E, market value to book value, price to sales, enterprise value to sales, and enterprise value to EBITDA). However, they found that the EBITDA multiple resulted in the most precise valuation. Interestingly, Lie and Lie (2002) have also demonstrated that the EBIDTA multiple should be preferred even to EBIT, because depreciation expenses distort the information value of earnings. Moreover, EBITDA multiple is a more suitable measure in mature industries such as the Food & Drink industry (Fernàndez, 2001).

Following the method used by Koeplin et al. (2000), the family firm discount or premium in this study was estimated as follows:

Family firm Discount = 1 − (Family firm Multiple/Nonfamily firm Multiple).[3]

Results

The descriptive statistics and correlations of the study's variables are presented in Table 2. The family firm discount or premium is shown in Table 3. The EBIT multiple produced a statistically nonsignificant result. But when examining the EBIDTA multiple, which is the most appropriate measure to value a firm, our findings indicate that family firms' multiples are lower than those for nonfamily firms. Specifically, external investors acquire family firm targets at a moderately statistically significant discount relative to comparable nonfamily firm targets (discount mean: 16%; discount median: 5%; $p < .10$). That is, nonfamily firms are valued higher relative to comparable family firms. Hence, for two comparable businesses (one family, one nonfamily) with the same EBITDA figure, buyers would pay less (i.e., acquire at a discount) for a family firm than for a comparable nonfamily firm, thus confirming our hypothesis (see Table 3).

However, given the difference in results obtained with EBIT and EBIDTA multiples, as mentioned before, it is important to underline that the EBITDA multiple is preferred over the EBIT multiple in the academic and practitioner communities (see, e.g., Fernàndez, 2001; Lie & Lie, 2002) The practical importance of the EBIDTA multiple is further confirmed by the existence of an index provided by Argos Soditic & Epsilon Research, which measures the evolution of European private mid-market company prices via EV/EBITDA multiple (Argos Soditic, 2010). The index provider explains:

> We think this multiple [EBITDA multiple] is the most suitable for a European index as it is not impacted by the target's financial structure nor by its policies regarding depreciation and provisioning (which vary in time and between countries). It is also the closest readily available proxy for operating cash flow. (Argos Soditic, 2010, p. 3)

As concerns our data set, to further confirm the accuracy of the EBIDTA multiple over the EBIT multiple,

Table 2. Descriptive Statistics and Correlations

	Mean	*SD*	1	2	3	4	5
1. Assets	138.45	347.02	1				
2. Sales	157.11	314.41	.832**	1			
3. EBITDA	21.34	63.43	.910**	.872**	1		
4. EBIT	14.76	46.2	.882**	.841**	.988**	1	
5. Family dummy	0.5	0.5	−.07	−.11	−.1	−.09	1

Note. EBIT = earnings before interest and taxes; EBITDA = earnings before interest, taxes, depreciation, and amortization of intangibles. N = 146. Values expressed in US$ million (assets, sales, EBITDA, EBIT).
**$p < .01$.

Table 3. Family Firm Discount/Premium

	Family Firms		Nonfamily Firms		Discount		
	Mean	Median	Mean	Median	Mean	Median	Sig.
EBIT multiple	34.82	16.15	30.58	15.16	−14%	−7%	*ns*
EBITDA multiple	11.28	9.78	13.39	10.33	16%	5%	*

Note. EBIT = earnings before interest and taxes; EBITDA = earnings before interest, taxes, depreciation, and amortization of intangibles; *ns* = not statistically significant.
*$p < .10$.

Table 4. Coefficient of Variation of the Multiples

	EBIT Multiple	EBITDA Multiple
Family firms	3.12	0.52
Nonfamily firms	1.47	0.68
All firms	2.52	0.62

Note. EBIT = earnings before interest and taxes; EBITDA = earnings before interest, taxes, depreciation, and amortization of intangibles.

and the statistical significance of our result, we compared the coefficients of variation (standard deviation divided by the mean) of the two multiples. The EBIDTA multiple appears to have a much lower value of this coefficient (see Table 4). This indicates that there was more consensus about the value of the EBIDTA multiple than about the EBIT multiple in acquisitions included in our data set.

Additionally, it is worth noting that by running the analysis first with all 73 pairs of companies and then with the reduced data sets (see Data Collection), results did not change substantially. If there is no observable difference in the result when zero, one, or more than one family member are retained in the firm after the acquisition, then retaining family members does not bring any advantage from the acquirers' point of view. If the acquirers value family firms at a discount even if they retain family members (as it is in 59 acquirers out of 73), it indicates that they do not appreciate the family firms' advantages that can be transferred by the retained family members. This further supports our hypothesis.[4] Finally, to make sure that our result did not reflect poorer performance of family firm targets, we also ran a *t* test to compare the EBITDA and EBIT margins (i.e., EBITDA/Sales and EBIT/Sales) between family and nonfamily firm targets. The differences in the margins' means were not statistically significant (EBITDA/Sales: Family 13.73%, Nonfamily 13.94%, *ns*; EBIT/Sales: Family 9.22%, Nonfamily 9.16%, *ns*), thus allowing us to conclude that family and nonfamily firms have the same levels of performance as measured by margins (see Baliga, Moyer, & Rao, 1996).

Discussion

In the present study, we explored the overlooked topic of valuing family firms in the context of acquisitions. Specifically, our objective was to shed light on the valuation of family firm targets when compared with nonfamily firm targets. Previous studies confirmed that family firms outperform nonfamily firms, thus suggesting that the stewardship perspective prevails over the stagnation perspective (e.g., Anderson & Reeb, 2003; Miller et al., 2008). Yet our results showed that in the eyes of external investors, stagnation disadvantages prevail over stewardship advantages because they perceive the family firm as an unprofessional and inefficient organization, thus negatively affecting its valuation when compared with a similar nonfamily firm target. Accordingly, when examining the EBIDTA multiple our empirical analysis confirmed the hypothesis that acquirers pay less (i.e., acquire at a discount) for a family firm target than for a nonfamily firm target. Also, although the EBIT multiple produced a statistically nonsignificant result, it offers some interesting insights. Indeed, it appears that EBIT of both family and nonfamily firms are valued similarly (Koeplin et al., 2000), which implies that acquires fail to discriminate between family and nonfamily firm targets. In light of this result, we may speculate that acquiring companies are unable to recognize the advantages associated with a family firm target when compared with a nonfamily firm target.

Contributions

Some contributions emerge from our study. First, the present research contributes to filling the gap in the family firm literature regarding the study of valuation of privately held family firm targets in the acquisitions context. Our study indeed represents the first empirical research to shed light on the valuation of family firm targets when compared with nonfamily firm targets, showing through the EBIDTA multiple that acquiring companies pay a lower price for a family firm target.

Second, the academic and business communities have often encouraged family firm scholars to rely more on a matched-pairs methodology to develop comparable analysis between family and nonfamily firms (Westhead & Cowling, 1998). We adopt this method in our study and use two well-known and commonly used multiples (i.e., EBIT and EBIDTA) that have not been employed in family firm studies to date. Furthermore, following the study of Jorrison, Laveren, Martens, and Reheul (2005), adoption of the matched-pairs methodology enabled us to discover "real" differences rather than "sample" differences between family and nonfamily firm targets.

Finally, to the best of our knowledge, the data set used in this study represents a "unique" collection of data; it comprises family firms as target companies and, despite the difficulty in obtaining financial information for family firms, contains a set of family firms whose financial information at the time of acquisition was disclosed.

Limitations

Several limitations should also be noted. We argue that a family firm is a more solid organization when compared with a nonfamily firm given that family members invest greater resources in employees' training, customer relationships, research and development, and company reputation (Miller et al., 2005; Miller et al., 2008). However, although we did our best to ensure that the data reflected a certain degree of family influence after the transaction (see Method), our data did not allow us to fully investigate whether family firms' characteristics are effectively persistent after acquisition. The present gap needs to be addressed in future studies on acquisitions and valuations of family firms. Although we are aware of the difficulty in achieving this goal, building a larger data set including family firm targets in which multiple family member managers are retained in the active management of the acquiring company will help in this direction. In such a case, postacquisition performance when the target company is a family firm versus a nonfamily firm should also be examined.

Furthermore, given the data limitation, we were unable to match our companies for earnings growth.[5] However, Alford (1992) obtained evidence that, if controlled for industry type, additionally controlling for earnings growth in the analysis does not reduce valuation errors. In other words, "industry appears to be a good surrogate for the component of . . . earnings growth related to multiples" (p. 107).

Finally, the generalization of our findings remains limited to the specific industry and geographical areas on which our data set was built.

Research Implications

This article may be regarded as a point of departure for guiding and pushing forward further research. First, given that acquisitions are an important part of the business process of redeploying resources into more productive uses, more research should be directed toward how family firms' resources can be effectively integrated into the acquiring company and whether the process may be facilitated when the acquirer is also a family firm (Feito-Ruiz & Menéndez-Requejo, 2010; Miller, Le Breton-Miller, & Lester, 2010). Recent studies argue that within an inter-firm cooperation, when both parties involved are family firms, similarity in the family status provides a contextual understanding (Chirico, Ireland, & Sirmon, 2010). Both parties benefit from complementary resources, shared levels of commitment, and similar appreciation of socio-emotional wealth, thus leading to a competitive advantage (Stockmans et al., 2010). Hence, family firm acquirers could be more willing to pay a premium for family firm targets, as they may be better suited to leveraging synergies based on family-specific common resources.[6]

Second, although most previous studies confirm that family firms perform better than nonfamily firms, we admit that this may appear somewhat unrealistic and not general to all family organizations that are heterogeneous entities. Future studies should detail to what extent such a superior performance of family firms exists, especially when acquirers need to evaluate potential family versus nonfamily firm targets. Following the same line of thought, several questions require further exploration. For instance, is it enough that a family firm is a solid organization at the time of acquisition for acquirers to pay a premium when compared with comparable nonfamily firms? To what extent and under what conditions do idiosyncratic family characteristics persist after acquisition? And, even though Miller et al. (2008) did not find support for the stagnation perspective, do the possible negative aspects of a family firm underlined by the stagnation perspective, such as conservatism and nepotism, disappear once the family firm is acquired in the new company? Future research clearly needs to be channeled in these directions.

Third, with few exceptions (see Miller et al., 2008), most of the empirical results on which we base our theoretical section stem from the analysis of large and public firms. On the contrary, although our data set is composed of medium-large companies, these companies are privately held. Future studies may replicate our work on a data set of public companies and find out whether results would change for public organizations.

Fourth, accounting measures of value may be also a possible line for future research. For example, scholars may further explore whether difference in multiples we found can be also attributed to differences in accounting practices in family versus nonfamily firms (Cascino, Pugliese, Mussolino, & Sansone, 2010; Yang, 2010).

Finally, scholars may take into consideration the quantity of transferred shares so as to account for control discount effect. For instance, the control discount effect would be lower if transferred shareholding interest is about 51% and higher if it is about 100%.[7]

Practical Implications

This research has several practical implications. For the acquirers, we show that family firm targets are undervalued relative to comparable nonfamily firm peers (see EBIDTA Multiple's result). We argue that their "real" value is not recognized by the acquirers. The typical due diligence processes in mergers and acquisitions commonly focus on financial health and rarely extend beyond to identify special knowledge stocks held by targets. Consequently, if family firms' idiosyncratic family knowledge or other positive characteristics prove significant in a specific target, this may provide a unique investment opportunity for acquiring companies. Instead, the acquirer tends to underestimate the family firm target's value and is inclined to pay less for a business whose value may be in fact higher, and thus risks losing valuable investment opportunities when the family firm target is averse to selling at a lower price.

Acquirers also need to understand that a part of target company's managers should be retained in the acquiring company, especially when the target company is a family firm with members who possess idiosyncratic knowledge and values that are hard to imitate or acquire elsewhere (Chirico, 2008; Chirico & Nordqvist, 2010; Chirico & Salvato, 2008). The key is to find target firms with complementary human capital (i.e., knowledge stocks) that remains and becomes part of the main company. In doing so, the process of recombining existing resources with external resources gained via acquisition can be quicker and easier after the acquisition.

For family firm owners, we showed that their firms are likely to be assigned a lower value than they are worth. The negative consequence for the family firm target is evident: It gets less money than it is worth. Hence, family firm targets need to send positive signals to their acquirers to mitigate the general negative perception that the potential acquirers may have regarding the family organization form. They need to explicitly prove the solidness of their firm, given that such firm was built and managed to last long. Instead, family firms are commonly characterized by a low level of transparency and managed with a "veil of secrecy" (Castillo & Wakefield, 2006, p. 49). Moreover, family firm targets need to persuade acquirers that their advantages will persist. This goal may be achieved, for instance, by retaining multiple knowledgeable family managers in the company, by having in place long-term customer contracts, by agreeing to accept a part of acquisition payment on reaching some milestone (e.g., revenue target), or by quantifying and reporting intangible family-based resources to third parties, and so forth.

In conclusion, we hope that this research informs, extends, and encourages future work on family firms' acquisitions and suggests changes in the managerial way of thinking when a family firm target is involved in the acquisition process.

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Notes

1. More information is available from the authors on request.
2. The implied equity value is the value of the entire outstanding share capital of the target company as valued by the acquirer. This value always represents 100% regardless of what stake is actually being acquired. The net debt is equal to all interest-bearing debt minus cash and cash equivalents.
3. A negative family firm discount reflects a family firm premium.
4. We thank one of the anonymous reviewers for this insightful comment.
5. We were able to collect information on earnings growth only for 47 observations for family firms and 37 observations for nonfamily firms. As expected, after performing the *t* test, the mean growth rates of family and nonfamily firms were found to be statistically insignificant.
6. We thank the editors for this helpful comment.
7. We thank one of the anonymous reviewers for this insightful comment.

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