

## **Importance of Transferring Tacit and Experiential Knowledge as well as Social Capital of Founders for Innovativeness of Successors in Smaller Family Firms**

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*Abstract: The main goal of our research was to examine the importance of transferring tacit and experiential knowledge as well as social capital of founders for innovativeness of the next family generation, i.e. successors in smaller family firms. Data were collected through in-depth case studies, including face-to-face structured interviews with 20 founders of smaller family firms and their successors. The research was carried out in Slovenia, which in our opinion still belongs to transition economies. Namely, transition from an economic-developmental aspect means transition from routine to innovative economy and society, which Slovenia has not achieved yet. Therefore, we find the innovativeness of next family generation owners and/or managers as crucial for transition of Slovenia to innovative economy and society. We assume that findings of our research may also have implications for other transition economies.*

*Keywords: smaller family firms, innovativeness, successors, next generation, family business transfer, tacit knowledge, experiential knowledge, social capital, transitional economy, Slovenia*

## 1 Introduction

**»One must learn by doing the thing, for though you think you know it – you have no certainty, until you try.«** **Sophocles, 400. B.C.**

Most of national economies are dominated by family firms [16, 22]. Mandl [20] estimates, that there are 70-80% in EU and that they employ 40-50% of all employed. One of the major problems family businesses face is the transfer of ownership and management to the next family generation [e.g. 27]. Transfer of company to the next generation is often a critical event in a life time of a firm [e.g. 12] and it should mean promotion of innovation ability (so-called invention-innovation diffusion-processes: IIDP) in smaller, so-called micro, small and medium sized family firms (smaller family firms: SFF), not only substitution of entrepreneurial resources [13]. While recently family firms and succession have often been subject of research and since the nineties in former century the interest is constantly growing [2], the question of SFF ability for IIDP remains relatively unexplored [4]. Many research studies address the problems linked to the transfer of tacit and experiential knowledge [3] to the next generation family businesses owners/managers as well as importance of transferring such knowledge for the success of a family firm after the transfer [e.g. 28]. Importance for the survival and long term development of transferred family businesses is also attached to the transfer of social capital [e.g. 19, 30]. However, there is lack of research which would examine the role and importance of transferring tacit and experiential knowledge as well as social capital for the innovativeness of the next generation of family businesses owners/managers.

Therefore, the main research questions addressed herein are: How does the transfer of founder's tacit and experiential knowledge influence the successor's innovativeness in SFF? How does the transfer of founder's social capital influence the successor's innovativeness in SFF? The research, presented and discussed herein, aims to improve our understanding of the importance of transferring tacit and experiential knowledge as well as social capital of founders for innovativeness of the next family generation, i.e. successors in SFF. The research was carried out in Slovenia, which in our opinion still belongs to transition economies. Namely, transition from an economic-developmental aspect means transition from routine to innovative economy and society, which Slovenia has not achieved yet. Since it is estimated that between 40 to 60 percent (even 80 percent) of Slovenian SMEs are family ones [for references see 9], we find the innovativeness of next family generation owners and/or managers as crucial for transition of Slovenia to innovative economy and society. We limit our research to the first (founding) generation family firms which prevails in Slovenia as well as in some other former socialist countries [for references see 9]. We assume that findings of our research may also have implications for other transition economies.

## 2 Literature Review

Cabrera-Suarez et al. [3] determine that one of the main problems in the process of succession is the need of the next generation to obtain founder's knowledge of the business, in order to maintain and improve firm's operations, as this knowledge can be source of firm's competitive advantage [1]. Specific family techniques and knowledge have to be transferred to the next generation, which makes customers believe in a high level of products and services [e.g. 10] and accelerates IIDP [25]. Knowledge contains information, technology, know-how and skills [14], which are explicit or implicit (tacit knowledge), therefore personal. Sharma [28] as well said that transfer of tacit knowledge to the next generation is of strategic importance to maintain and develop a family business after the transfer to the next generation. Szulanski [31] identified and defined four possible barriers for transferring knowledge: random ambiguity and unproven correctness, owner of knowledge is not motivated to transfer knowledge, the next generation is not motivated to receive knowledge, factors of circumstances, like barriers in organization, and a bad relationship between previous and the next generation.

Innovations are a key competitive activity of a knowledge based global economy [13]. Development of new products, introduction of improvements are very important for survival in a global world of competitiveness. More than production and ability to produce at the lowest costs it is important that the next generations of entrepreneurs in SFF have entrepreneurial education and enough knowledge for IIDP. As well a relationship between the next generation and innovation in a family firm is very interesting [13]. According to Steier [30] innovation ability of firms is complemented by social capital, which is defined as a stock of resources and abilities in a network of relationships between firms and/or people. Lee, Lim and Lim [19] and Steier [30] say, that transfer of social capital to the next generation is of crucial importance for maintainance of a firm and its long-term development, as well as openness for interaction and cooperation beyond geographic and technological borders.

One of SFF characteristics is a relatively high ability to respond to changing environment and needs (if they do not have specialized equipment, note of author). Less bureaucracy, more clan structure and culture [8], characteristic of SFF, can improve inter-organizational confidence, communication and cooperation ability, which contributes to innovativeness [e.g. 29]. On the other side, there are other characteristics which indicate that SFF have difficulties in adjusting to changes on economical, technological and competitive markets [6]. Managers of SFF often do not have education and training, connected with innovativeness / IIDP [26], and innovativeness in SFF is positively correlated with employment of managers with relevant external training and formal education. SFF are a closed type of firms, often they employ on the basis of family connections and not the ones with the best abilities for a certain field of work,

which is a negative factor for introduction of new management practices and IIDP of products, which could as well affect efficiency and profitability of firms [15]. In SFF power and decision making are concentrated in owner / manager [11]. Innovative processes should be included in company's philosophy, culture, policy, and strategy. SFF should form creative environment and introduce many methods for creative thinking and decision making [34]. The owners/managers are also creating the two most important sources of innovations: the managerial and the organizational types of innovations [24]. So for innovativeness we can conclude, it is the innovativeness of the owner/manager and not of the firm [32].

### **3 Research**

#### **3.1 Research Goal**

The main goal of our research is to examine the importance of transferring tacit and experiential knowledge as well as social capital of founders for innovativeness of the next family generation, i.e. successors in SFF. Our basic proposition is that the transfer of tacit and experiential knowledge as well as social capital positively influences the innovativeness of successors in SFF. In order to achieve the research goal we developed four research constructs:

C1: Examination of the transfer of tacit and experiential knowledge of founders to the successors in SFF.

C2: Examination of the transfer of social capital from founders to successors in SFF.

C3: Examination of the innovativeness of founders.

C4: Examination of the innovativeness of successors.

#### **3.2 Research Methodology**

In our research we used a case study research methodology, which we found as a suitable research approach due to the explanatory nature of our research [33]. As proposed by Yin [33] we used a multiple-case study approach, where replication logic was possible. In-depth case studies, including face-to-face structured interviews with top managers – owners / founders and successors in Slovenian SFF, were conducted. Case studies' analysis was used to identify themes emerging from the data in relation to knowledge management and innovativeness of successors in SFF.

### 3.3 Sampling and Data Collection

Our research was not limited to small and medium sized family firms (from 10 to 249 employees) only, as we suppose that numerous micro family firms from zero to nine employees face the problem of transferring ownership and management to the next generation as well. This is why we talk SFF. Limitation for the sample is that founder of the firm is employed in a firm or still owns a firm and that next generation is involved in a firm. Most of family firms in Slovenia are SFF, thus large firms are not included.

Research is geographically limited to Slovenia. Twenty SFF from data basis of the authors were selected. The authors conducted personal interviews with top managers – owners / founders and successors in SFF. This type of research is appropriate for research on the field of business, as in-depth interviews can enlighten findings resulting from data, collected by quantitative research [17]. A “top management team (TMT)” approach to sampling, involving more interviewees from a SFF, was applied. The first question was, “do you consider your firm as a family firm?” Using this approach, applied by Chua, Chrisman, Sharma [5] and Sharma, Chrisman, Chua [27], we avoid threat, that answers would not be representative, as they include answers of different interest groups from a SFF. All 20 interviewed founders confirmed that their firms are family firms. All examined firms were private with the following legal forms: 14 (70%) limited liability companies, and 6 (30%) individual private entrepreneurs. The size of the examined firms was defined by the average number of employees in a business year and the structure of the sample was the following: 9 (45%) were micro firms with up to 10 employees, 7 (35%) were small firms with 10 to 49 employees and 4 (20%) were middle sized firms with 50 to 249 employees.

### 3.4 Research Results and Discussion

The transfer of a firm (ownership and partly management) to the next generation was already done in one firm (5%) in 2008. 17 founders (85%) mostly plan succession at a retirement in 3 to 15 years; two (10%) do not plan succession yet. They would like their children to become successors, but have not discussed it yet. When we asked their children, 4 (20%) said that they are not chosen for successors yet, and only one (5%) did not know if he is chosen for a successor or not. 19 children (95%) see themselves as successors, only one says that he does not see himself as a successor of a family firm yet. Except one, all founders plan transferring management and not ownership to successors in the first phase. Reason for choosing a particular child as a successor is mostly that it is the only, the oldest or the most competent child, being involved in firm's operations since childhood, thus having knowledge and some experience. 5 founders (25%) explicitly said that they would rather sell a firm then leave it to a non-family member, while 3 founders (15%) had no problem in transferring managerial role

to a non-family member, but ownership should stay in hands of the family. In Table 1 data on succession plans and potential successors are presented.

Succession characteristics	No. of firms	% of firms
Written plans for succession	15	75
Knowledge about plans (but not written ones)	3	15
Neither plans neither knowledge about plans	2	10
<i>Total</i>	<i>20</i>	<i>100</i>
Successors:		
A son	6	30
A daughter	3	15
two sons	3	15
two daughters and one son	2	10
two sons and a daughter	1	5
A daughter and a son	1	5
A younger wife and a son	1	5
A son in law	1	5
<i>Total</i>	<i>20</i>	<i>100</i>
Successors not employed but active	4	20
Successors employed	14	70
Successors worked through their own firms	2	10
<i>Total</i>	<i>20</i>	<i>100</i>

Table 1  
 Succession plans and successors

In Table 2 data on founder's education (background) and successor's education, their work experience and experience from other firms are presented. While founders are on average less educated than their successors, successors are mostly holding a high degree (bachelor) in economics, most of them in entrepreneurship. All successors are actively involved in their family firms either from childhood (11; 55%), since high school (5; 25%), or since the beginning of study (4; 20%). Regarding their functions in firms, 6 (30%) have been already active in managerial roles as directors, executive director or deputy director, 14 (70%) are leading departments of marketing, finance or production.

Background (education, work experience, work experience in other firms) characteristics	Founder		Successor	
	No.	%	No.	%
<i>1. Education / total</i>	<i>20</i>	<i>100</i>	<i>20</i>	<i>100</i>
• Vocational degree	9	45	0	0
• High school	3	15	7	35
• Higher degree (2 years of college)	2	10	0	0
• High degree (3 years of college or a university degree)	5	25	12	60
• Master degree	1	5	1	5

2. Average work experience (in years)	33,4		6,9	
3. Work experience				
• relevant for founding the firm	15	75	-	-
• partly relevant for founding the firm	4	20	-	-
• irrelevant for founding the firm	1	5	-	-
• internships in other firms	-	-	8	40
• experience in other firms	18	90	7	35
• no work experience in other firms	2	10	5	25

Table 2  
 Founders' and successors' education, work experience and experience in other firms

In Table 3 data on innovativeness of founders and of successors are presented.

Innovativeness characteristics	Founders		Successors	
	No.	%	No.	%
1. Selling products, services, processes as a result of own knowledge and development	15	75		
2. Development of »new to the world« products, services	10	50		
3. Improvements of existing products, services	15	75	15	75
4. Development of new and improvement of processes	13	65		
5. Adaption of existing solutions »new to the firm« on products, services, processes	17	85		
6. Protection of property rights				
• patents	1	5		
• model protection	1	5		
• brand protection	2	10		
7. Development of new products, services, processes in the recent 5 years / total	20	100		
• up to 13 products, services, processes	14	70		
• none	6	30		
8. Involvement into development of products, services, processes / total			20	100
• products			6	30
• services, processes			13	65
• idea generation			1	5
9. Risk-taking, coping with challenge			20	100
10. Being entrepreneur or manager / total			20	100
• entrepreneur			10	50
• manager			3	15
• entrepreneur and manager			7	35
11. Starting a new firm with own idea / total			20	100
• yes, if in different field of activity			5	25
• yes, if in the same field of activity			2	10
• no			1	5
• other solution			12	60

Table 3  
 Innovativeness of founders and successors

Although most founders report constant development of new products, services, processes, in order to remain competitive in their industry, they have not protected products, services or processes, with exception of 4 founders (20%) – one of them has 2 patents on his name and 2 patents he sold, two founders protected brands and one a model. One founder and his successor are currently working on innovation which will be patented. Successors all report constant development activities, but only 5 (25%) of them said that they develop products, services, processes together with their parent, others (15, 75%) report own development of new solutions especially in IT, improvements of existing services and processes, simplifications, which lead to cost reduction. Most of the successors, 10 (50%) assess themselves as entrepreneurs, but only 2 of them would definitely start a new business as they could better express and develop their creativity. Regarding willingness to take risk and face challenge all of successors are ready to do it all the time.

In Table 4 data on importance and transfer of tacit knowledge and social capital are presented.

Characteristics of transferring tacit and experiential knowledge and social capital	Founders		Successors	
	No.	%	No.	%
1. <i>The art of transferring / receiving tacit and experiential knowledge / total</i>	20	100	20	100
• internal / individual training	7	35	1	5
• mentoring	1	5	11	55
• coaching	2	10	5	25
• observing parent at work and simply get involved	5	25	0	0
• problem solving	1	5	0	0
• combination of methods, also involving into meetings with partners	3	15	3	15
2. <i>Importance of academic knowledge for competitiveness of a firm /total</i>	20	100	20	100
• important	12	60	20	100
• not important	8	40	0	0
3. <i>Importance of social capital for development and implementation of new ideas</i>				
• social networks are very important for development and implementation of new ideas	19	95	18	90
• a HR factor in a firm is crucial for success of a firm	18	90	0	0
• confidence level between the founder and successor(s) is very high, relationship is strong	18	90	19	95
• interaction, dynamics of relationships of family members in a firm is very strong	18	90	15	75

Table 4  
 The importance of transferring tacit experiential knowledge and social capital



Founders usually transfer their tacit knowledge (which is result of their work and experiences) to their family members, mostly children, and not always or limited to one child only. In most of the cases the transfer of knowledge is done by internal or individual training, sometimes combined with mentoring or coaching, or learning by problem solving. Mostly children were not involved into meetings with partners until they expressed a clear wish to work in a firm or got employed in a firm. In most cases children have been involved in a family business already since childhood, they could observe parents at work, parents served as a good »example«, and started mostly to do summer jobs or week-end job since high-school. Successors reported a slightly different picture as they understood that they were mostly mentored, one even by a co-worker and one by a professional consultant, but also they explicitly distinguish between internal and external training and do not understand it as transfer of founders knowledge. Most of the founders believe that academic knowledge is important for competitiveness of the firm as it opens horizons, but they also believe that this knowledge should be combined with work experience, joy for work, feeling for trade.

Social capital is often not understood by founders, most of them understand it as relations between workers, a human factor in a firm. Social networks are crucial for success and further development of a firm. Social networks are crucial for success and further development of a firm. Only one (5%) successor said that relationship with founder is not strong, but regarding his father's character, this is a maximum, which can be developed. 4 successors said that their relationships have improved only recently with the increasing level of confidence.

### **Conclusions**

The results of our research show that the transfer of tacit and experiential knowledge as well as of social capital positively influences the innovativeness of successors in SFF. The founders are well aware how crucial it is to transfer their experience and knowledge to the younger generation in order to assure competitiveness and sustainability of a family firm. They believe that it is very good to let successors observe them at work, get involved in daily operations, into meetings and negotiations with partners and to let them find solutions by themselves and also take responsibility for decisions. They mostly believe that studying and getting academic knowledge, as well as work experience in other firms is important for the development of firm's products, services and processes. However, they find especially important the experience and early involvement in firm's operations which enables younger generation to start breathing with a firm. Most founders have no problem with delegating their managerial role, but rather postpone transfer of ownership beyond their retirement age. Regarding social capital, the research results show that it is either unknown category, or mostly taken as relationships between family members, or between employees. When explained, they strongly agree, that social capital as a bundle of social networks, HR (family members and non-family members), relationships and level of confidence with successors contributes to a more creative environment and development of new ideas.

Innovativeness of founders was higher at the beginning of their entrepreneurial careers, while younger generation is sparkling with new ideas, which mostly result in introduction of improvements or new processes in a firm, many of them leading to rationalization of business processes. Most of the successors see themselves as successors, as entrepreneurs and not managers and they are actively and constantly involved in development of new products, services, processes and improvement of the existing ones. This is a result of a strong and dynamic relationship with their parent / founder, a high level of confidence and their willingness to learn.

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