

»» Ageing boosts SMEs' need for successors – 620,000 business transitions by 2018

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The KfW SME Panel reports that 17 % of Germany's small and medium-sized entrepreneurs plan to transfer or sell their business by the year 2018. This will affect some 620,000 small and medium-sized enterprises (SMEs) with over 4 million employees.

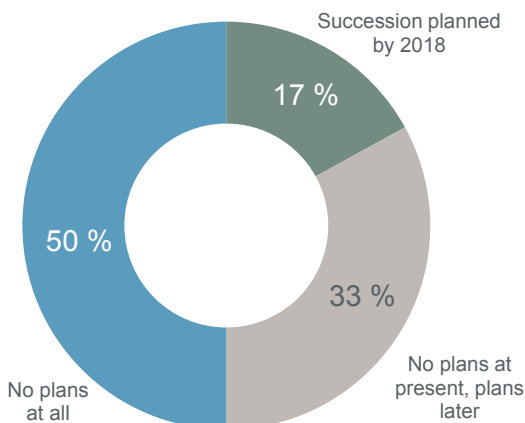
Demographic change gives reason to fear that the road to business succession will soon be a rather bumpy one. For one thing, entrepreneurs are growing older and the number of SMEs about to change ownership is rising year after year. For another, there is a shortage of potential successors. Start-up activity has stagnated for years, further exacerbating this demographic problem. Each year there are now roughly three times more businesses in need of a successor than entrepreneurs willing to take them over.

A special survey conducted by Creditreform and KfW Research on business succession revealed that time is running out for a considerable portion of SMEs. Only 42 % of SMEs that are intended to change owners in less than three years have initiated the succession process. More than one third still have no concrete plans.

620,000 transfers planned by 2018

The KfW SME Panel shows that some 17 % of small and medium-sized entrepreneurs in Germany are planning to hand over or sell their business to a successor by the year 2018 (Figure 1). That is around 620,000 enterprises with more than 4 million employees.¹

Figure 1: Short-term succession plans in the SME sector



Source: KfW SME Panel 2015

The share of SMEs with an upcoming change of ownership has risen steadily from 14 to 17 % in the past years; their number has grown from 530,000 to 620,000 (Figure 2). This trend is mostly demographic, as the share of over 55-year-old SME owners grew from 20 to 35 % between 2002 and 2014.²

More successors are needed, but not enough are coming

When the baby boomers retire from working life over the next 20 years they will leave a big gap – including on the executive floors of SMEs. The reason is that subsequent generations are much smaller in size. For each person aged between 55 and 70 in the year 2000 there were still 2.6 younger individuals (aged 20 to 54). That ratio has already dropped noticeably to 2.4 today and is predicted to be just 1.8 in the year 2030.³

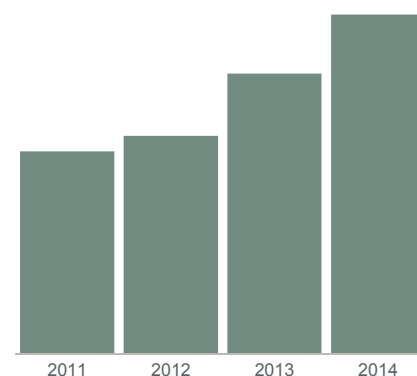
Labour market puts the brakes on start-up activity

This imbalance is not the only problem. The already shrinking pool of potential successors is also being used less efficiently than in the past, as start-up activity in Germany has remained on a low level for several years now.

The same is true of business ventures started by taking over an existing business. In 2002 the KfW Start-up Monitor identified more than 200,000 such acquisition start-ups, but that number has plummeted to only one third (71,000 in 2014 and 62,000 in 2015).⁴

Figure 2: More and more SMEs are approaching transition

Number and proportion of SMEs planning succession in around three years



Source: KfW SME Panel 2012–2015.

More than one third of businesses facing transition are still without concrete planning

Under these circumstances it is not surprising that many SMEs are behind with their transition arrangements. A joint survey conducted by KfW Research and Creditreform (see box on page 5) shows that only 42% of SMEs set to change owners in less than three years have initiated the succession process. At any rate, 22% have concrete plans, but 25% have so far only gathered information and 11% have not even begun to deal with the issue (Figure 3).

As a consequence, time is running out for more than one third of upcoming business transitions. After all, transferring a business is a long-term undertaking that requires careful preparation. The Association of German Chambers of Industry and Commerce therefore recommends that concrete planning and the search for a successor should begin no later than three years before the transition.

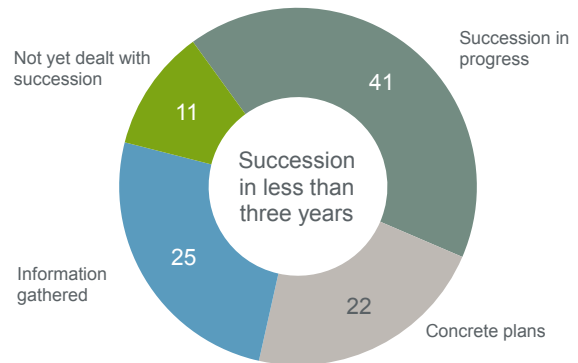
Many SMEs are fixated on family succession

Significantly more than half (56%) of SMEs generally consider handing their company over to a family member (multiple answers were possible). An external buyer (e.g. a start-up entrepreneur, another business or financial investors) is an option for 48% of business owners while 43% can imagine a transfer to co-proprietors and/or employees. Only 6% see business closure as an option (Figure 4, left).⁵

The majority of SMEs (59%) have committed themselves to a single transition variant. Family succession is the only option for 29%, external sale the only option for 18% and leaving the business to employees or co-proprietors is the only option for 12%. In contrast, 41% of small and medium-sized entrepreneurs are more flexible and consider more than one variant of company succession (Figure 4, right).

Figure 3: Not all SMEs plan well ahead

Stage of succession planning when transition is to take place in less than three years. In per cent



Source: Creditreform / KfW survey on company succession.

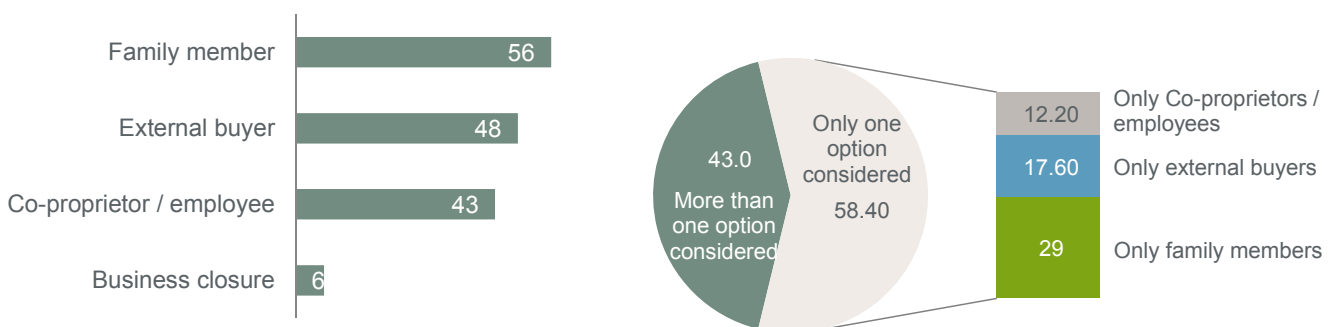
Associations are the most important source of information

Planning and executing a business succession are complex processes with numerous organisational, tax and legal pitfalls. Business owners therefore need to collect a great deal of information before and during the transition: How do I find a suitable successor? What steps do I have to take and when, and what documents do I need? What purchase price, realistically, can I ask for?

Clearly, the main sources of information on these and numerous other issues for SMEs are the chambers of commerce and industry and business associations, which provide their members with support in the form of information material, seminars, consultations and other measures. More than half the entrepreneurs who have already contemplated retiring refer to associations as one of their main sources of information (52%, Figure 5). Thirty-nine per cent of entrepreneurs rely on specialist books and magazines for guidance on business succession.⁶

Figure 4: Family succession has priority

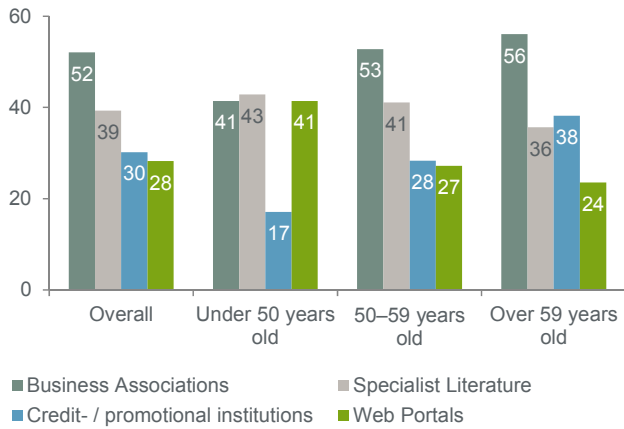
Successors considered by entrepreneurs (multiple answers were possible). In per cent



Source: Creditreform / KfW survey on company succession.

Figure 5: Associations are the most important source of information

Important sources of information on business succession from the perspective of entrepreneurs (by age group). Multiple answers were possible. In per cent



Source: Creditreform / KfW survey on company succession.

Younger entrepreneurs turn to the internet for information, older ones to associations and banks

Depending on their age group, entrepreneurs use different sources of information. Associations and, above all, credit institutions become increasingly important for ageing entrepreneurs. Thirty-eight per cent of over 59-year-olds turn to banks and promotional institutions for information, but only 17% of under 50-year-olds. The significance of web portals (e.g. online succession platforms), however, drops significantly with age. The internet is used for information by 41% of younger entrepreneurs, but only by 24% of the older ones (Figure 5).⁷

Success factors from a business perspective: intensive successor training and customer care

Obtaining information is only the first step on the path to a successful business transition. From an SME's perspective, the most important success factor lies at the end of this path: intensive familiarisation of the successor with the business. This aspect is considered particularly important by 72% of entrepreneurs (Figure 6).

Another crucial factor is retention of customers and suppliers (60%), who often have personal ties with the outgoing business owner. But the successor must earn the trust not just of business partners, but also of the workforce so as to keep valuable skills within the company: 51% of entrepreneurs mentioned acceptance by the employees as a very important success factor. Clearly, an effective in-house and external communication policy is essential.

Planning ahead, letting go in good time

A successful transfer also requires a certain amount of lead-up time and good timing. Accordingly, around half of SMEs emphasise the need to start looking for a successor early (52%) and to plan several years ahead (49%).

A similar share (48%) believe the success of a business succession depends on whether the outgoing entrepreneur

finds the right moment to let go. Emotional aspects may be a hindrance, as many struggle to leave their life's work in the hands of strangers or accept that they have health issues and that their performance is declining.⁸

Coordination with financing partners is also in the interest of outgoing owners

Entrepreneurs regard close coordination with financing partners as less important. Only 18% consider it a success factor. However, the expertise of financing partners is not just important for potential successors, it can also be valuable for outgoing business owners. A widespread problem in succession negotiations is that parties disagree on what constitutes a reasonable purchase price – also because outgoing owners factor in emotional aspects when setting the price.⁹ The sober view of the financing partners can thus be helpful to all stakeholders.

Do businesses underestimate modernisation requirements?

Only few entrepreneurs regard the modernisation of their business prior to a transfer as an important success factor (13%). This view can lead to problems because existing owners should also assess the competitiveness of their company critically in the years before they retire – and take action if necessary. Are equipment and IT systems up to date? Are distribution channels and marketing strategies in line with the times? Are modern staff training and professional development strategies in place? The chances of a successful transfer are generally better if the enterprise is positioned for sustainability when the time comes.

Figure 6: Successful transition through intensive preparation

Important factors for a successful transition from the perspective of entrepreneurs. Multiple answers were possible. In per cent.



Source: Creditreform / KfW survey on company succession.

However, modernisation presupposes a willingness to invest that many entrepreneurs lack. As past surveys by KfW Research have shown, older entrepreneurs' investment decisions are fraught with particular uncertainty.¹⁰ In some cases it is not until the owner leaves that an investment yields returns – to the successor. When the sale of the enterprise is planned the question arises whether interested buyers expect similar returns on investment so that they are appropriately reflected in the achievable purchase price.

When outgoing entrepreneurs answer this question with “No”, modernisation investment falls by the wayside.

Top of the wish list: less red tape

Business transfers necessarily involve bureaucracy, especially a number of information and reporting requirements. These include financial administration (income and inheritance tax, real property transfer tax), trade offices, district courts (commercial register, property register), chambers of commerce, professional associations and employment agencies or even labour courts. This part of the succession process is where SMEs see by far the greatest need for support, with two thirds preferring fewer bureaucratic requirements.

Entrepreneurs see much less need for support with promotional financing programmes (29%) than with reducing bureaucratic obligations. The vast majority of SMEs also do not see any serious problems in the area of advisory services (24%) or the search for successors (16%) (Figure 7).

Conclusion: Plan ahead and strengthen entrepreneurial skills

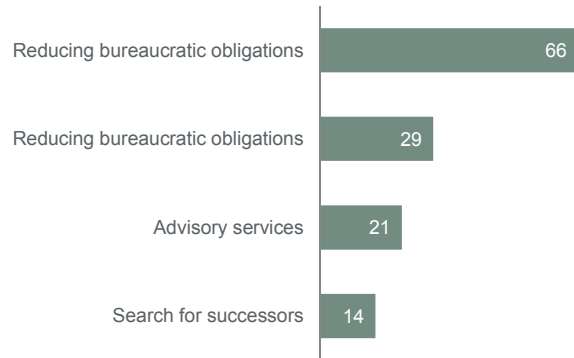
Successful business transition is becoming a growing challenge for the SME sector. When the transfer or sale to the following generation of entrepreneurs is delayed or even fails, investment, competitiveness and jobs come under pressure. The present analysis has identified three core problems of business succession.

First, many entrepreneurs appear to turn their attention to their succession at a late stage even though it is a complex process that needs to be planned carefully. More than one third of business owners who plan to retire within three years have not yet entered the stage of concrete planning.

Second, business succession faces a fundamental demographic bottleneck. As entrepreneurs grow older, the number of SMEs about to change ownership increases year after year. However, the subsequent generations are not only less populated but also currently less inclined to start their own business. In the currently favourable labour market environment, many who would in principle be interested in starting or taking over an existing business prefer salaried employment over self-employment.

Figure 7: Cutting red tape would help

Need for help in business succession from the point of view of SMEs. Multiple answers were possible. In per cent.



Source: Creditreform / KfW survey on company succession.

The “dormant reserve” is also held back by lack of entrepreneurial skills. These include, among other things, an appetite for risk and decisiveness, proactiveness and financial literacy.¹¹ Tomorrow’s entrepreneurs should learn more about these essential preconditions even before they leave school. Today’s entrepreneurs and successors already have access to a broad range of coaching and training offers, although there is still potential to increase their participation rates.

Third, SMEs identify the reduction of bureaucratic barriers as the area where most support was needed. Progress was recently made here. The so-called compliance costs (in money and time expended) have dropped for the first time since 2011, primarily due to the Act to reduce Bureaucracy of 2015, Small enterprises in particular benefit from the higher thresholds for accounting and information obligations.

Red tape can be cut even further, as the Council for the Review of Legal Norms has also demanded.¹² This council of experts sees potential especially in digitisation, for example in online data exchange with government authorities (e-government) and in bringing contacts with government services together on a single platform (one-stop shops). ■

Database: KfW SME Panel and Creditreform / KfW survey on business succession

The KfW SME Panel (KfW-Mittelstandspanel) has been conducted since 2003 as a recurring postal survey of small and medium-sized enterprises in Germany. The basic population of the KfW SME Panel includes all private-sector companies from all industries with annual turnovers of up to EUR 500 million.

With a database of up to 15,000 companies per year, the KfW SME Panel is the only representative survey of the German SME sector, making it the most important source of data on issues relevant to the SME sector. The main survey of the 13th wave was conducted in the period from 23 February 2015 to 26 June 2015.

Information on a planned company succession is collected only in the year of first inclusion in the dataset. Data are available from the survey years 2012 to 2015. Further

information and the current annual report can be obtained at www.kfw-mittelstandspanel.de.

Complementing data from the broad-based KfW SME Panel, this study also uses data collected by the Verband der Vereine Creditreform e. V. (Federation of Creditreform Associations) specifically on business succession in the SME sector in cooperation with KfW Research.

The survey addresses details such as the various stages of succession planning, the importance of various sources of information and the factors that contribute to a successful business transition from the entrepreneurs' point of view. A total of 1,200 owner-managed businesses were surveyed that have up to 500 employees and generate a turnover of up to EUR 50 million. Subsidiaries of corporations were excluded.

¹ The values determined by the KfW SME Panel 2015 are in line with the results of the three previous years (14 % or some 530,000 businesses in 2011; 15 % or approx. 540,000 businesses in 2012, and 16 % or 580,000 businesses in 2013). Confidence intervals of 95 % were calculated for the reporting year 2014 as well. The interval for the share of SMEs seeking intra-family succession oscillates between 8 and 10 %. The interval for the proportion of SMEs seeking external leadership succession oscillates between 7 and 9%. If we take into account the bottom margin (some 15 % overall) and the top margin (some 19 % overall), the interval width is around 550,000 to 697,000 entrepreneurs who are planning to transfer or sell their business to a successor by the year 2018.

² The figures show that small and medium-sized entrepreneurs age even faster than the general population. The share of over 55-year-old people in the German population increased by "only" four percentage points (from 29 to 33 %) in the same period. Sources: KfW SME Panel and Federal Statistical Office.

³ Source: Federal Statistical Office, population updates based on the 2011 Census and 13th coordinated population projection (Variant 1).

⁴ For a detailed analysis of start-ups by acquisitions in Germany cf. Metzger, G. (2016), Succession-ready enterprises outnumber acquisition start-ups 3 to 1, Focus on Economics No.133, KfW Research, Frankfurt am Main. The advisory statistics of the German Chambers of Industry and Commerce also illustrate the mismatch between existing owners and potential successors. The number of existing owners seeking advice or successors is rising year after year while fewer and fewer potential successors approach the chambers. (Cf report by the Association of German Chambers of Industry and Commerce on business succession in 2015). Apart from imbalanced numerical correlations there are matching problems, e.g. new entrepreneurs' lack of entrepreneurial skills, different ideas about purchase prices, and false expectations about the complexity of business succession. On balance, 43 % of existing owners who received advice from the chambers of industry and commerce do not find a suitable successor, while 46 % of potential successors for their part fail to find a suitable business.

⁵ Business closure is an option considered more often (13 %) by small SMEs (1–5 employees).

⁶ Most entrepreneurs (57 %) use only one of the mentioned sources of information.

⁷ This can be attributed not only to younger entrepreneurs' potentially greater internet affinity, but also to the fact that business transitions are still a thing of the future for them and many use the internet to familiarise themselves with the subject.

⁸ For example, not even one in three businesses has an 'emergency kit' – urgently recommended by experts – with important instructions and documents that enable or facilitate an unexpected necessary transition (source: Report by the Association of German Chambers of Industry and Commerce on business succession in 2015).

⁹ According to estimates by the German Chamber of Industry and Commerce, 40 % initially ask for an inflated purchase price (source: Report by the Association of German Chambers of Industry and Commerce on business succession in 2015, p. 11).

¹⁰ Cf. Schwartz, M. and J. Gerstenberger (2015), Ageing of German SME owners is putting a dampener on investment, Focus on Economics No. 85, KfW Economics Research, Frankfurt am Main; Schwartz, M. and J. Gerstenberger (2015), Succession planning in SME sector in full swing: Half a million hand-overs by 2017, Focus on Economics No. 91, KfW Economics Research, Frankfurt am Main; Haunschild, L., Tchouvakhina, M. and A. Werner (2010), Unternehmensnachfolge im Mittelstand: Investitionsverhalten, Finanzierung und Unternehmensentwicklung, KfW Economic Research, Standpunkt No. 5, Frankfurt am Main (in German)

¹¹ Cf. Leifels, A. and G. Metzger (2015), Financial literacy helps with business start-ups: easier, better funded, more competitive, Focus on Economics No. 107, KfW Research, Frankfurt am Main.

¹² Cf. National Council for the Review of Legal Norms (2015), Chancen für Kostenbegrenzung verbessert (*Cost-cutting opportunities improved*, in German)