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Status report on SME succession 2020: Well-prepared into the crisis – coronavirus exacerbates start-up downturn

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The coronavirus crisis has foiled many SMEs' plans for the future. For the first time, KfW's status report on SME succession shows that in 2020 more than half of small and medium-sized enterprises (SMEs) have no clarity as to whether and when they should transfer business operations to a successor. Still, the representative data of the KfW SME Panel paint a cautiously optimistic picture. First, most of the older entrepreneurs, whose withdrawal is imminent, at least adhered to their succession plans even in the crisis. Second, SMEs entered the crisis well-prepared and are continuing succession processes they have already initiated. Negotiations for nearly half of the approx. 260,000 transfers planned for the next two years have been completed, while negotiations with interested potential successors are continuing for a further one third.

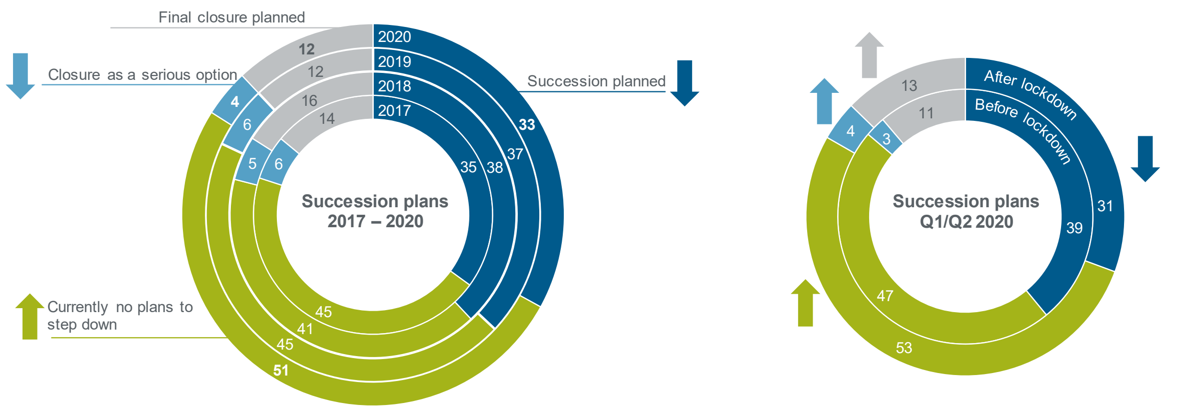
This positive snapshot from the first half of 2020 is conditional on whether the coronavirus crisis will continue to be mitigated by government assistance and, in particular, on whether it will pass in the near future (thanks to vaccines). Otherwise, medium-term succession plans could be delayed for too long, and even well-advanced succession negotiations could still fail. In fact, already there are signs of an increased likelihood of business closure plans since the spring lockdown.

One fundamental problem of company succession remains unchanged and has been further exacerbated by the coronavirus crisis: the shortage of successors due to unfavourable demographics and weak entrepreneurial spirit. As the analysis by the KfW Entrepreneurship Monitor has revealed, takeover entrepreneurs have an above-average need for finance and are particularly susceptible to the potential risks of founding a business. Besides, they are more likely to be concerned that running a business is hard on their family life. Founding a business as a team can spread this burden across several shoulders but too often entrepreneurs fail to find suitable partners.

When the baby boomers retire from the workforce over the next 10 to 15 years, they will leave a large gap – including on the executive floors of SMEs. With its annual 'Status report on SME succession', KfW Research analyses the future plans of owners of small and medium-sized enterprises (SMEs), in particular whether they plan to close down or hand over their business to a successor after they retire.[1] The analysis is based on the data from the KfW SME Panel, which surveyed around 10,000 SMEs between February and June 2020, among them a good 2,000 on the topic of succession (see box on page 7). This period covers the coronavirus-induced restrictions on business activities, beginning with the 'hard lockdown' at the beginning of spring (23 March to 19 April 2020). It shows that the coronavirus crisis is already having a significant impact on business succession.

Figure 1: Planning uncertainty in the coronavirus year – first signs of abandoned succession plans since the lockdown

Succession and closure plans of SME owner-managers after withdrawal from business (percentages of all SMEs in per cent). Left: annual comparison 2017–2020; right: comparison within the survey waves of 2020 (February/March vs. April-June).



Source: KfW SME Panel 2017–2020.

Note: This paper contains the opinion of the authors and does not necessarily represent the position of KfW.

Lockdown has foiled succession plans

In the coronavirus year of 2020, the first thing that catches the eye is that a good half of entrepreneurs – 51% – have no specific ideas at all about their withdrawal and what will come afterwards (Figure 1 left). That is a generally predictable and uncritical order of magnitude since roughly half the entrepreneurs are, after all, below the age of 55 (49%, Figure 3), so they often have no urgent need to make any specific plans. What is remarkable nevertheless is that in previous years much fewer SMEs were without specific plans. Earlier shares ranged from 41 to 45%. We interpret this substantial difference as a coronavirus effect. The crisis is making the future less certain and bringing acute problems into focus.

The detailed analysis of the data following the survey period confirms the causal relationship between succession and the coronavirus crisis. The data collected on future-oriented topics since early April deviate significantly from the months of February and March. The spring lockdown influenced not just expectations on turnovers and employment but also the issue of succession. With the lockdown, the share of SMEs without specific succession considerations jumped from 47% (February/March) to 53% (April to June, Figure 1 right).

Vacancies for management positions slumped in April

The uncertainty caused by the coronavirus crisis also has practical implications for the search for successors. This is exemplified by changes in advertisements posted on the online platform www.nexxt-change.de, a business succession exchange that brings together entrepreneurs and interested potential successors (see box 1). The platform normally advertises over 600 new vacancies per month, as it did at the beginning of 2020. In February, for example, around 650 new advertisements were posted while in April is was only 300 (Figure 2). In the course of the summer and autumn, advertisements increased slightly but remained well below the pre-crisis level. Another negative trend is emerging for October and November. (Based on the data of previous years, the trend described here cannot be attributed to seasonal effects).

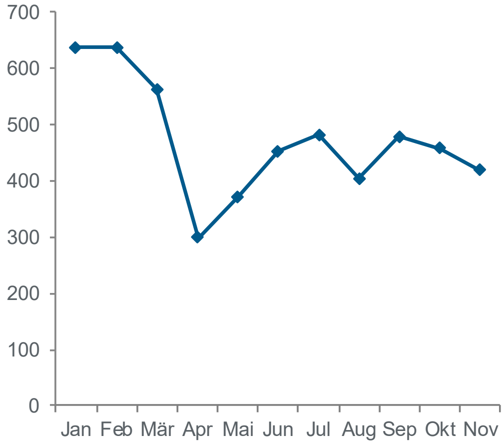
Succession failed as a result of the coronavirus crisis?

Currently 33% of all SMEs are planning for succession and 16% are heading for closure. (For 12%, closing down is the only option and for 4% a serious option besides succession). In 2019 the share of succession planners was still 37%. Are SMEs abandoning their succession plans under the weight of the coronavirus crisis and more likely to accept closing down?

On the one hand, ‘no’. The share of SMEs not planning for succession has dropped by four percentage points on 2019. However, closures are also being planned less often, falling from 18 to 16% (Figure 1, left). In essence, both are an expression of heightened uncertainty. A comparison between annual data from 2019 and 2020 at least shows no clear evidence of a shift from succession to closure, as the rates of decline are relatively similar.

Figure 2: Fewer management positions advertised on nexxt-change

New monthly advertisements for business succession on the internet platform nexxt-change in the year 2020



Source: nexxt-change.

Box 1: The business succession platform nexxt-change

www.nexxt-change.de is a nationwide business succession exchange that was launched in 2006. Its purpose is to bring entrepreneurs who are interested in a succession arrangement together with business founders. It is an initiative of the Federal Ministry of Economic Affairs and Energy, KfW Group, the Association of German Chambers of Industry and Commerce, the German Confederation of Skilled Crafts, the Federal Association of German Cooperative Banks and the German Savings Banks and Giro Association in collaboration with the partners of the ‘nexxt’ initiative.

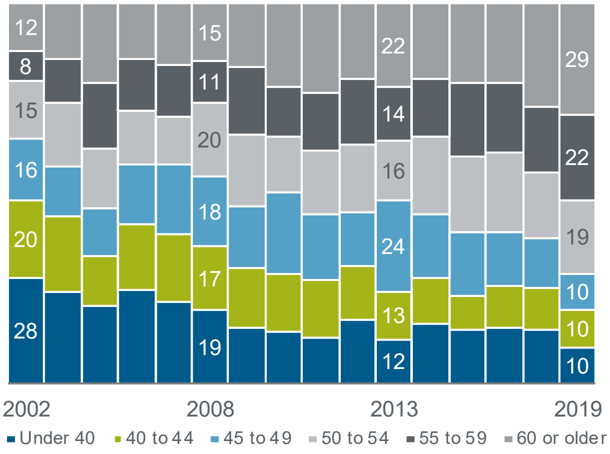
Succession planners and entrepreneurs interested in taking over a business can post an anonymous advertisement on nexxt-change and research the database. Advertisements are created with support from a regional partner (e.g. a chambers or savings banks). Their task is to provide quality assurance and coordinate the process of bringing the parties together. The platform hosted some 6,000 advertisements and 1,500 searches on average in 2020.

The longer the crisis drags on, the higher the risk of closures

On the other hand, a detailed analysis after the time of the survey provides first indications that the crisis is increasing the likelihood of closures. The data sample after the lockdown (from April) shows not just a sharp increase in uncertainty but also a shift away from succession towards closure plans compared with the sample from February and March. The shares of businesses with succession plans fell from 39 to 31%, while the proportion of potential closures rose from 14 to 17% (Figure 1, right).

Figure 3: Entrepreneurs continue to grow older

Age of SME owner-managers, 2002–2019 (in per cent)



Source: KfW SME Panel 2002–2020.

This trend towards closures is a snapshot of a particular moment taken on a limited database that must be interpreted with caution. But this pattern is likely to become more entrenched the longer the economic downturn and turnover weakness continue. The answer to the question 'Will closures become more common?' therefore is: So far, not many succession plans are likely to have failed but the risk rises the longer the crisis continues.

Ageing increases need for successors in the short term

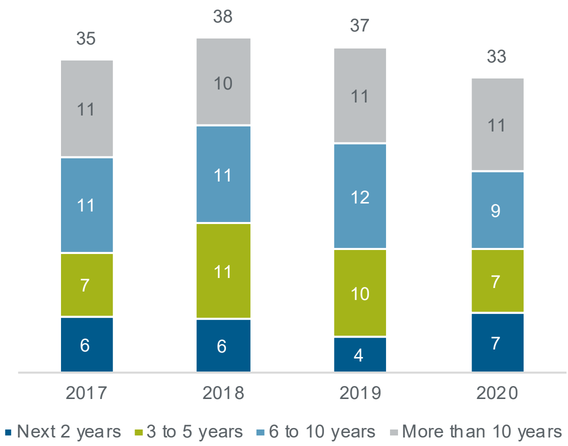
A further finding of the analysis refutes the notion of a directly imminent slump in business successions. Entrepreneurs whose withdrawal is imminent are adhering to their succession plans even in the crisis. Thus, the ageing of the population is fully impacting on the number of imminent successions. Already 29% of SME owner-managers are over the age of 60 (Figure 3) and 13% are over 65. The share of SMEs that want to complete their succession already in the next two years rose to 7% across the SME sector in 2020. That share was 4 to 6% in previous years (Figure 4).

While short-term succession plans are being largely maintained despite the crisis, the medium-term generational transition could stall. Transfer plans intended for implementation in three to five years are less common than in the previous year (7 vs. 10%). Apparently, it is mostly owner-managers with a slightly longer time horizon who are switching to crisis mode and suspending their succession planning.

Business succession is a complex process. A sufficient planning horizon, diligent preparation, the right timing and realistic expectations are crucial factors for success.[2] The chambers of industry and commerce recommend that the specific search for a successor should begin no later than three years before the transfer.[3] Against this backdrop, it is essential for enterprises to be released as quickly as possible from having to deal with securing their immediate survival and to be able to return to important issues of the future.

Figure 4: More short-term succession plans

Planned time of withdrawal of SME owner-managers with succession plans, reporting years 2017–2020 (shares in per cent).



Source: KfW SME Panel 2017–2020.

Well-prepared into the crisis – succession process remains on track despite coronavirus

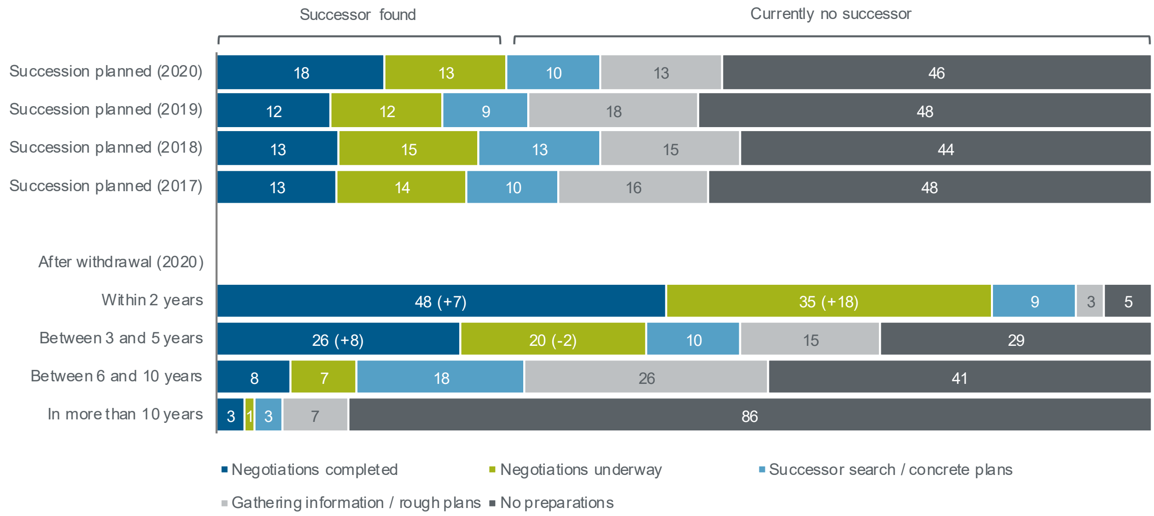
The preparations of SMEs that have adhered to their succession plans even in the crisis are well on track so far. Overall, 31% have already found a successor (Figure 5). More than half of these (18%) have already finalised their negotiations. Both rates are well above the previous years' level. In 2019, 24% of businesses planning their transfer found successors, and 12% of them completed their negotiations. In monitoring successions over the years, KfW Research has identified a clearly positive trend. SMEs are increasingly better prepared – and thus better equipped for unforeseeable crises. One probable reason is growing awareness about the topic from empirical studies and more widespread media coverage.

Given the necessary planning horizon, the status of imminent successions is obviously of particular importance for successful generational transition in the SME sector. Further improvements can also be seen in the transfers planned for the next two years. A significantly higher proportion of SMEs – 83% – have found a successor than in the previous year (58%). Of these, 35% are in succession negotiations and 48% have already concluded their negotiations.[4]

In 'normal' times, succession processes with ongoing negotiations can be seen to have positive prospects. In the coronavirus year of 2020 there is a risk that even well advanced negotiations have to be deferred or restarted because of sudden changes in conditions – or, in the worst of cases, fail shortly before they reach the finish line. However, the data available on the period since the lockdown (so far) do not

Figure 5: Half of the transfers planned for the next two years are in the bag

Status of business succession preparations by years (top) and planned withdrawal timeframe (bottom) (shares in per cent; change on the previous year in percentage points in brackets).



Source: KfW SME Panel 2017–2020.

point to any setbacks in the planning status. Depending on how the crisis evolves, that could change in the coming months.

Currently, successions are at the greatest risk of failing for around 17% of those owner-managers whose withdrawal from management is imminent in the next two years. Of these, 9% are looking for successors, 3% have only collected information so far and 5% have not even begun to plan their succession. They are at risk of having their withdrawal delayed or even of involuntary closure. Here as well, the trend is positive. In 2019, 21% of imminent successions were still affected by such planning delays.

Coronavirus has exacerbated the shortage of business founders

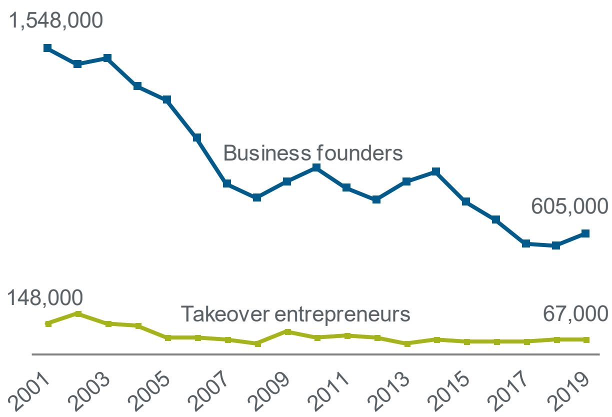
The 7% share of SMEs requiring a successor within the next two years represents around 260,000 enterprises. The number of takeovers is well below that figure and has been at around 70,000 per year for quite some time now. The latest figures of the KfW Entrepreneurship Monitor for the year 2019 show that takeovers have dropped from 72,000 in the previous year to 67,000 (Figure 6).[5]

In other words, a structural succession gap exists that ultimately cannot be reduced without significantly increased start-up activity. After all, the age structure of entrepreneurs is a demographic fact of life. Yet there are no signs of a start-up boom – neither in start-up activity in general nor in takeovers in particular. For the year 2020, preliminary data from the current survey of the KfW Entrepreneurship Monitor give cause for concern that takeover activity will decline further. (The KfW Entrepreneurship Monitor 2021 will be published in the spring.)

The official statistics of business notifications capture only corporate start-ups (not sole traders) but they clearly point in the same direction. 'Takeovers of existing businesses'

Figure 6: Entrepreneurial activity remains in a lull

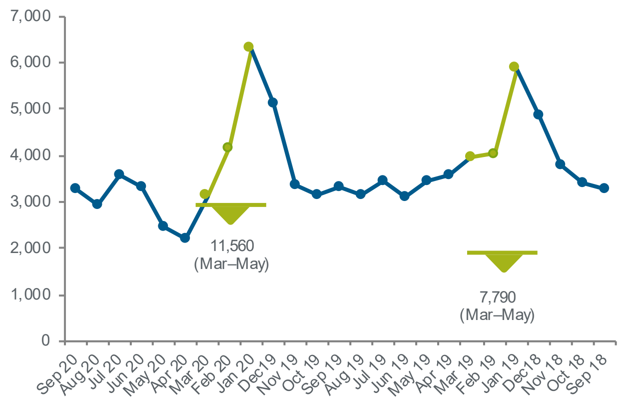
Number of business founders (total and takeover entrepreneurs)



Source: KfW Entrepreneurship Monitor 2002–2020.

Figure 7: Business notifications in the lockdown low

Notified 'takeovers of existing businesses' by months



Source: Statistics of business notifications (Destatis Fachserie 5, Reihe 2).

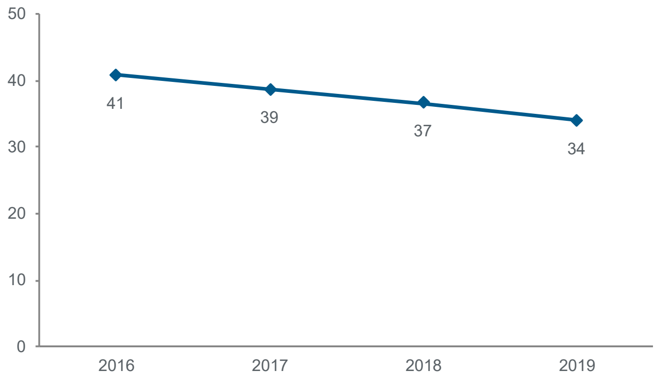
plunged with the lockdown. The 7,800 takeovers from March to May 2020 represent a drop of 33% from the 11,600 takeovers in the same period of 2019 (Figure 7). Business notifications initially returned to a normal level in the summer but catching-up effects are not yet discernible.

KfW Entrepreneurship Monitor: Family succession has become less common

Year after year, takeover entrepreneurs account for approx. one tenth of overall entrepreneurial activity. A distinction can be made between two very different types of takeover entrepreneurship: within the family and from outside (e.g. through an acquisition from outside the business or also by employees/co-owners). On average for the years 2016–2019, 38% of takeover start-ups remain within the family. A declining trend can be identified here: from 41% in 2016 to 34% in 2019 (Figure 8). This development has to do with the demographic trend because the outgoing generation of entrepreneurs has a historically lower number of children. Moreover, it can be assumed that they increasingly base their educational and career choices on their individual interests and pursue them more often outside the parents' business.

Figure 8: Family succession is becoming less common

Share of family succession in all business takeovers (in per cent).



Source: KfW Entrepreneurship Monitor 2017–2020.

Takeovers tend to be larger

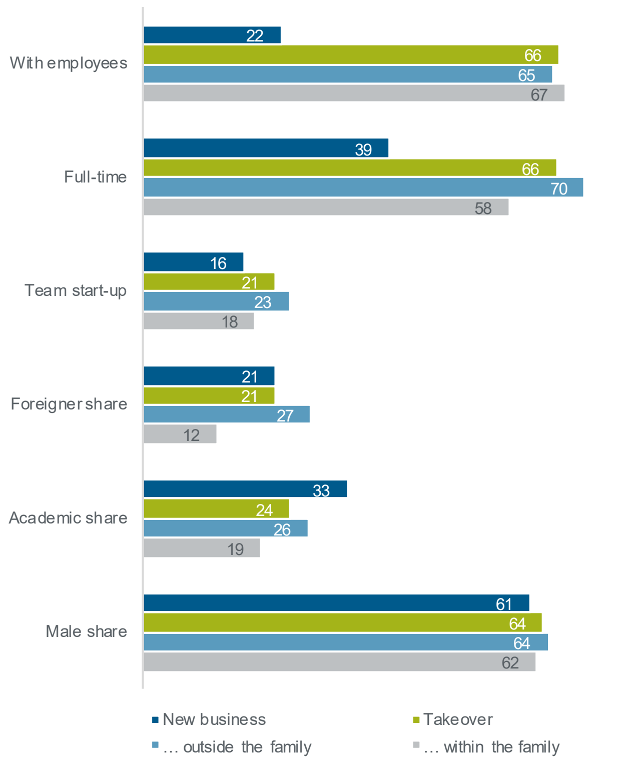
Takeover entrepreneurs differ in several points from those who set up a new business. On average over the last four years (2016–2019), takeovers have been undertaken slightly more often by men than by women (64 vs. 61%) and less often by graduates (24 vs. 33%, Figure 9). But the main difference is that takeovers are larger on average. Takeover entrepreneurs are more likely to enter full-time (66 vs. 39%), are naturally more likely to have employees already in the first year (66 vs. 22%) and are more likely to take over as a team (21 vs. 16%). External takeovers are particularly common as a full-time activity (70%) and as a team effort (23%). They also have a high share of non-German nationals (27%), although in within-family takeovers, by contrast, this share is less than half (12%) and hence below average.

.... and have higher financing needs

Larger start-up projects involve higher financing needs. New entrepreneurs often get by without any finance (33%) or with amounts below EUR 10,000 (45%). In the years 2015–2019, only 22% of new entrepreneurs invested more than EUR 10,000. For takeover entrepreneurs this share is more than twice as high, at 46%. Financing volumes in excess of EUR 50,000 in particular are much more common in takeovers (23 vs. 6%, Figure 10).

Figure 9: Takeovers are more likely to be full-time

Comparison of takeover and new start-up characteristics (average for 2016–2019, shares in per cent)



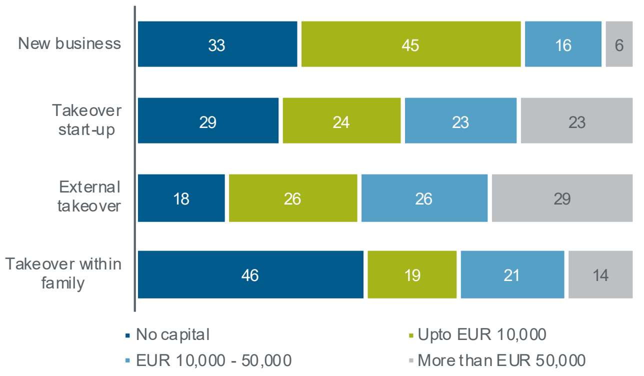
Source: KfW Entrepreneurship Monitor 2017–2020.

External takeovers have particularly high financing needs. Only 18% of them require no finance at all, while 29% invest more than EUR 50,000. Within-family takeovers, on the other hand, are carried out even more often using no finance than new start-ups (46%), while medium financing volumes between EUR 10,000 and EUR 50,000 are relatively common (21%).

The different financing needs of within-family and non-family takeovers are mainly due to the fact that a purchase price is paid in only 22% of within-family successions but in two out of three non-family transfers (67%). Purchase prices are also much lower. Only in around one in ten within-family transfers is the price above EUR 10,000, compared with one in two non-family transfers.[6]

Figure 10: Takeover is more capital-intensive than a new start-up

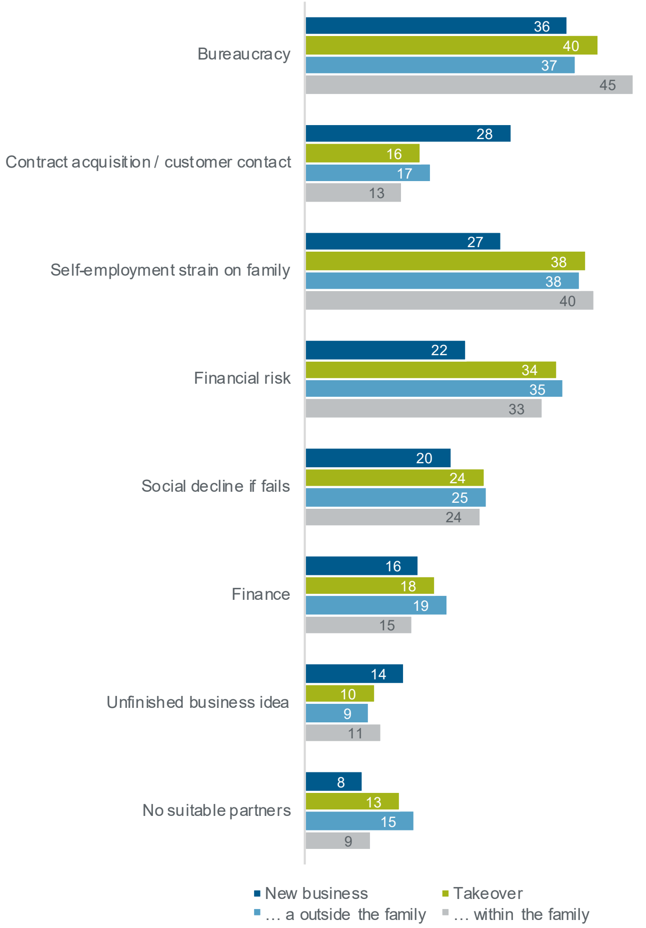
Funds used by new and takeover entrepreneurs (average for 2016–2019, shares in per cent)



Source: KfW Entrepreneurship Monitor 2017–2020.

Figure 11: Financial risk is a burden for takeover entrepreneurs

Perceived difficulties in takeovers and new start-ups (average for 2016–2019, shares in per cent)



Source: KfW Entrepreneurship Monitor 2017–2020.

Financial risks and burden on family are barriers to start-ups

Entrepreneurs perceive certain difficulties in different ways in takeovers than in newly founded businesses. Thus, difficulties in customer acquisition are less common when acquiring an existing business (16 vs. 28%, Figure 11), since customer contacts already exist. Consequently, problems with undeveloped business ideas are also fewer (10 vs. 14%). On the other hand, given the higher financing needs, takeover entrepreneurs are more likely to have reservations about the financial risk involved in starting their business. This affects a good one third – 34% – and thus significantly more than new start-up entrepreneurs (22%). Furthermore, non-family takeover entrepreneurs are more likely to encounter problems in finding suitable co-founders (15 vs. 8% of new start-ups).

Founding a business takes time and costs nerves. Takeover entrepreneurs are even more likely than new start-up entrepreneurs to admit that running a business is a burden on their family (38 vs. 27%). This is true of non-family as well as within-family takeovers and is likely to be directly related to the above-average size of the start-up projects. Takeover entrepreneurs on average invest more working hours in their business venture (42 vs. 27 hours a week). Even if we look exclusively at full-time businesses, a large difference remains (53 vs. 45 hours a week).

It appears that the problems that are typical of takeovers – burden on family, lack of partners, financial risk – also act as genuine barriers to starting a business. These points are mentioned particularly often by takeover entrepreneurs who have already abandoned their project. Other difficulties such as red tape and customer acquisition, by contrast, are perceived almost in equal measure in both abandoned and continuing start-up projects. The feared burden on the family and a lack of team partners also act as a barrier during the business planning phase. Plan discontinuers see greater problems here than entrepreneurs who have put their plans into practice.

Conclusion: Business succession is not in acute jeopardy – but first warning signs

The coronavirus crisis has foiled many SMEs' plans for the future. In 2020, businesses were suddenly confronted with existential problems – loss of turnover, liquidity bottlenecks, and worries over the viability of their business model. For the owner-managers, this has pushed considerations on their future withdrawal from the business into the background. A good one half of SMEs currently have no specific ideas about their succession or closure – clearly the highest rate since 2015, when KfW began monitoring SME succession.

To be sure, the detailed evaluation of the data collected before and after the spring lockdown has delivered first indications that the likelihood of closures could rise as a result of the crisis. But based on the prevailing economic environment, the current snapshot paints a largely positive picture of SME business succession:

1. Entrepreneurs whose withdrawal is imminent are adhering to their succession plans even in the crisis. SMEs with a slightly longer timeframe are more likely to be putting their plans on hold.

2. Succession processes already underway remain well on track so far. Negotiations have been completed for half of the transfers planned for the next two years and they are ongoing for a further one third. That is the highest level of succession activity so far recorded by KfW.

Coronavirus assistance enables SMEs to plan for the future

It should be noted that this positive snapshot of the first half of 2020 is subject to an important caveat: Successful generational transition in the SME sector also depends on the severity and progression of the coronavirus crisis. For example, putting plans for medium-term succession off for too long diminishes the chances of success. After all, successful business transition usually requires several years of planning. And even well-advanced negotiations – with the finish line in plain sight – can fail if the overall environment changes dramatically.

It is therefore essential for enterprises to be released as quickly as possible from having to deal (only) with securing their immediate survival and to be able to return to important issues of the future. The current advances in vaccine development are therefore also very important for business succession, as it appears realistic that business activity can return back to normal from the spring. In the meantime, government assistance that secures continued liquidity for SMEs while signalling political determination coming out of the crisis is a key building block.

Not enough takeovers – financial risks are a barrier

A further building block consists in activating and supporting (potential) takeover entrepreneurs. After all, the unfortunate combination of unfavourable demographics and diminishing entrepreneurial spirit[7] means that the demand for successors will outstrip the supply for years to come. Within-family succession remains extremely important in the SME sector but the share of non-family transfers will continue to increase for purely demographic reasons. This will push the availability of finance more into focus since non-family takeovers require finance more often, as well as higher amounts. Takeover entrepreneurs are also more likely overall to have concerns about the financial risk involved in starting their business than new entrepreneurs.

Starting up as a team spreads the burden over several shoulders

Our analysis has revealed other specific barriers to start-up activity. Takeovers tend to be larger than average start-up projects and require entrepreneurs to put in more work than average. Takeover entrepreneurs are therefore more concerned than average that their business activity will be too much of a burden on the family. Besides, they sometimes have problems finding suitable partners to put together the desired team. At the same time, founding a business as a team is a good way of dividing the work and financial load over several shoulders (and combining diverse talents). The trend towards non-family transition will create more opportunities to take over a business as a team. So there is valuable potential in targeted advice and networking for interested entrepreneurs. Successful takeover teams can act as role models and demonstrate how to successfully combine the continuation and modernisation of a business.

Box 2: Details about the database

The evaluations used in this paper are essentially based on two data sources: the KfW SME Panel and the KfW Entrepreneurship Monitor. Both are collected specifically by KfW Research and provide a representative database of small and medium-sized enterprises and entrepreneurial activity in Germany. The databases are also available to researchers in the context of research partnerships.[8]

KfW SME Panel

Enterprises with a turnover of up to EUR 500 million make up the total population covered by the KfW SME Panel. With a database of 10,000–15,000 enterprises per year, the KfW SME Panel is the only representative survey of the German SME sector. The survey of the 18th wave was conducted in the period from 10 February to 19 June 2020. The evaluations of this report are based on the responses returned by the more than 2,000 SMEs newly entered into the panel and surveyed on the topic of business succession.

KfW Entrepreneurship Monitor

The KfW Entrepreneurship Monitor is based on information provided by 50,000 randomly selected persons domiciled in Germany. They are interviewed by telephone on an annual basis as part of a representative survey of the population. It covers a broad range of start-ups: full-time and part-time entrepreneurs, self-employed professionals and business owners, newly founded businesses and takeovers, etc. The KfW Entrepreneurship Monitor thus provides a representative picture of all entrepreneurial activity in Germany.

[1] Last updated in Schwartz, M (2019), **Status report on SME succession: Planning steady at a high level**, Focus on Economics No. 241, KfW Research.

[2] For details see also a detailed survey in Leifels, A. (2016), **Ageing boosts SMEs' need for successors – 620,000 business transitions by 2018**, Focus on Economics No. 132, KfW Research.

[3] Cf. DIHK (2019), DIHK Report on company succession 2019, Berlin.

[4] The (approx. 540,000) SMEs whose succession is due in the next three to five years are also better prepared than before. In 2020, 46% found a successor but only 40% in the year before. In interpreting these figures, however, it must be borne in mind that many SMEs in this segment suspended their succession planning, so their planning status is not captured here. If poorly prepared enterprises, in particular, suspend their succession process, this can suggest an (apparent) improvement in their planning status.

[5] Metzger, G. (2020), **KfW Entrepreneurship Monitor 2020: Entrepreneurship in Germany in 2019: first growth in five years – 2020 overshadowed by coronavirus pandemic**, KfW Research.

[6] Purchase prices as reported by the takeover entrepreneurs. Additionally (or alternatively), paid transfers may have taken place against a pension or similar payment.

[7] Cf. Metzger, G. (2021, forthcoming), Jüngere stabilisieren „Gründungsgeist“ in Deutschland (*Young people stabilise 'entrepreneurial spirit' in Germany*), Focus on Economics, KfW Research.

[8] https://www.kfw.de/KfW-Konzern/KfW-Research/Über-KfW-Research/Forschungskooperationen/ (in German only).