

Passing the baton – encouraging successful business transfers

Evidence and key stakeholder opinion





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Evidence and key stakeholder opinion of business transfer issues

Background

Budget 2004 included the following announcement:

“Effective transition of business ownership has the potential to drive productivity benefits through improved innovation, investment and skills. However, ensuring a smooth succession of ownership can be especially challenging for smaller businesses who may not know how to get appropriate advice, and who may face barriers in raising finance to fund the transition. The Small Business Council has asked the Government to examine the barriers that might constrain business transfer. Martin Wyn Griffith, the Chief Executive of the Small Business Service, will lead a cross-departmental review of the hurdles that businesses face when their ownership changes, and what more could be done to ease the process.”

The review's outcomes support the Government's strategic policy framework for small businesses by:

- building an enterprise culture and encouraging new entrepreneurs to acquire an existing business, something that carries a lower risk than starting a new one;
- encouraging a more dynamic start-up market by encouraging the acquisition and subsequent growth of established businesses;
- encouraging small business growth by facilitating a successful change of ownership and transfer of knowledge, skills and other intangible assets; and
- encouraging more enterprise in disadvantaged communities and under-represented groups by ensuring that businesses which are commercially viable and critical to the fabric of the community, find new owners and continue to trade.

The Small Business Service sought evidence and opinion during 2004 to support the cross-departmental review in understanding the nature and extent of barriers faced by small businesses in achieving successful business transfer. (This document supports the report on the cross-departmental review which is available separately¹.)

For the purpose of this report, business transfer refers to the change of ownership of an SME associated with an owner's wish to retire or exit the business for some other reason.

¹ Passing the baton – encouraging successful business transfers, URN 04/1888, available from www.sbs.gov.uk

Report structure

The report is formed of two main sections. The first is focussed on available evidence from UK and overseas literature. That is, testable findings which have an underlying research methodology or data source. The second section presents opinions from representatives across government departments, businesses and other key stakeholder and interest groups. The views expressed in this section are often experiential or anecdotal rather than from a testable source.

The following outlines what is included within the two sections:

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INTERNATIONAL LITERATURE REVIEW

This was a review of the current literature and data sources, which aimed to:

- provide a comprehensive overview and understanding of the current position;
- identify key policy relevant issues; and
- outline issues for future research and policy agendas.

This study was commissioned by the Small Business Service and undertaken by Durham University Business School, led by Professor Ian Stone. The key sources drawn upon are described in the bibliography included as Part 2 of Section A.

BAROMETER SURVEY FINDINGS

A small number of questions on business transfer issues were included in barometer surveys of businesses and business advisers to get a feel for current attitudes and behaviour.

The UK Business Adviser Barometer is a monthly online survey of business advisers across the UK. It has been established as a collaborative project between the University of Nottingham Institute for Enterprise and Innovation and the Institute for Business Advisers. The UKBAB consists of around twelve questions constituting a mixture of topical subjects and quarterly repeated questions to generate trends data.

The UK Business Barometer is much the same, but targeted at business owners. The UK Business Barometer was originally developed as the East Midlands Business Barometer but is now UK-wide.

FOCUS GROUP

A focus group was undertaken to explore some of the issues consistently emerging across the review activities at that stage.

The focus group was facilitated by an independent researcher, Leigh Sear, of the Wood Holmes Group.

CALL FOR SUBMISSIONS

A call for submissions – with structured questions – was sent out to key stakeholders by the Small Business Service to obtain their views, opinions and experiences of business transfer. An overview of the responses is provided in Section B, Part 3.

A

SECTION A

PART ONE

A2

An international literature review carried out by Durham University Business School

PART TWO

A36

An annotated bibliography of key sources considered by the Durham University Business School team

A

Part one:

Business transfer

A policy orientated international literature review

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EXECUTIVE SUMMARY

A(i) Introduction

■ This report aims to inform the Government on the area of business transfer. It is based upon a literature survey of both UK and overseas sources and seeks to identify the extent and impact of transfer problems affecting businesses, the nature of any barriers to transfer of ownership experienced by different types of business, and forms of support and intervention which have been proposed or tried out elsewhere.

■ Business transfer refers to the change of ownership of an SME associated with an owner's wish to retire or exit the business for some other reason. Business transfer 'failure' relates to a situation where the business either closes or is diminished as an outcome of a deficient succession process. 'Successful' transfer is one that results in ultimate viability of the business and subsequent positive performance of the firm.

A(ii) Extent of the problem

■ It is estimated that around one-third of all EU firms are expected to change hands in the next decade, affecting around 610,000 SMEs and 2.4 million jobs. One-third of UK SME owners have been identified as 'vulnerable' to age-related transfer failure, and this vulnerability affects an increasing proportion of the SME owners.

■ There are no official statistics on business transfers, leaving large-scale surveys as the only source for estimates of the phenomenon. Measures of 'vulnerability to transfer' – widely used to indicate the growing scale of the problem – are unreliable in that they assume business transfer is related to retirement age. In fact, there is a large (and increasing) proportion of owners wishing to exit for non-age related reasons – accounting for as much as half of all business transfers.

■ Only a relatively small percentage of family-owned firms survive within the family: around 5-15% of such businesses reach the third generation. An increasing proportion of transfers occur outside the family, reflecting lack of interest on the part of family members in taking on the business, as well as the changing nature of businesses. This increase in outside transfers lends the business transfer market increased prominence.

■ Estimates based upon a 2001 UK Survey show that around 30% of closures might be regarded as 'transfer failures' – viable firms which close for lack of a suitable successor – rather than simple 'business failures'.

■ There are even fewer measures available of the extent of ongoing post-transfer success, especially among SMEs, than of the extent of business transfer failure. What little evidence there is shows that a high proportion of businesses are alive after five years, and suggests that taking on an existing business is a less risky option on average than starting-up from scratch.

A(iii) Broader perspectives

■ Not all closures should be looked on as 'failures'. Enterprise can thrive on 'creative destruction', and more than six out of ten exiting entrepreneurs who close their businesses go on to establish new businesses or devote their time to another of their businesses.

■ Business failure is consistent with a healthy, dynamic economy – sectors with a high number of business failures may be declining or no longer competitive, and in need of restructuring. The 'churning' process of entry and exits consists largely of small firms, so potential transfers are dominated by small firms (i.e. those with less than five employees)

■ Where failed succession of viable businesses happens in areas of deprivation (and remote rural localities) there may be higher social costs than in more buoyant areas – including the impact on other local businesses and regeneration, as well as the direct employment losses.

■ A significant benefit of a change of ownership can be innovation – ranging from changes in organisational structure and management practices of a business through to the introduction of new processes and products. However, while six out of seven successors make changes, not all change is truly innovative – change for change's sake arising from new management is unlikely to improve competitiveness or productivity.

A(iv) Obstacles to effective transfer

■ The two key aspects which contribute to successful business transfer are (a) the attributes of the owner-manager and his successor and (b) the ground rules by which the process is conducted.

■ To maximise chances of success, the owner and his successor should have similar value systems, and their relationship should be based in mutual respect and trust. Communication between both parties, and all other stakeholders in the business, overcomes stumbling blocks. The owner must be prepared to 'let go' of the business, and co-operate with, and delegate to, his successor.

■ The successor must be able to show credibility, commitment and legitimacy, principally through prior experience and interpersonal skills. To prepare for this, several studies recommend a lengthy handover process, where owner and successor are both involved in the business, possibly jointly managing it, especially where the business has an idiosyncratic management style. This implies that succession must be a planned process, initiated well in advance of the event.

■ Internal transfers of family-owned businesses need to be as carefully planned as market sales, as family relationships are consistently reported as the most significant predictor of the success of a transfer. Trust and affability, in conjunction with planning and preparation of heirs, should make a transfer run more smoothly. This can be encouraged through family charters or councils, or the use of independent 'enablers' (board members, consultants, non-involved family members etc).

■ Relatively few small businesses have a formal succession plan. Generally, around two-thirds report the existence of such a document, with a higher figure for larger businesses with more formalised management structures. There is little indication that the age of the owner-manager has much bearing on planning for exit.

■ For many business owners, a transfer to a family member is their preferred method of succession. However, family members are increasingly uninterested in taking on the business or may lack the skills necessary.

■ While the market for buying and selling businesses is highly active, small businesses often

find it difficult to locate an acceptable purchaser. Trade in businesses is hampered, in some sectors or areas of the country, by the difficulties in obtaining accurate information on the businesses and the idiosyncratic nature of some small businesses.

■ Tax constraints pose relatively few concerns for small business transfer in the UK, especially in comparison with family relationships. Following the successive adjustments to capital gains tax in recent years, it can be argued that tax is broadly neutral in its effect upon succession decision-making. Financial constraints were not found to exert a major influence. There is some evidence that small businesses located in disadvantaged areas have poorer access to capital compared to other areas of the country – lending support to the idea that succession problems may occur unevenly across the country.

A(v) Firm types experiencing business transfer failure

■ Research tends to focus more on managerial and generic issues surrounding business transfer, rather than sector, size of firm, etc.

■ Smaller firms tend to be more at risk of business transfer failure than larger. They are less likely to engage in business transfer planning, or staff development to create a pool of potential managers. Owner-managers also tend to be more likely to be concerned with 'lifestyle' rather than business objectives. Finally, the market for small firms is less efficient, primarily because owners often have a limited network of potential buyers and have difficulty finding an intermediary to act on their behalf.

■ The chances of business transfer failure in relation to industrial sector is an under-researched area. In general, those sectors with a high risk of transfer failure tend to be declining, increasingly uncompetitive 'traditional' sectors, with low levels of attractiveness to buyers. Examples include craft-based firms in construction; bakeries; hairdressers; clothing manufactures; and firms trading in textiles, clothing and paper products. Small retail firms, in general, have also been identified as at risk, since they often give priority to short-term cashflow and they are heavily dependent on interpersonal customer relationships.

A(vi) Support for the transfer process

■ The framework of initiatives being taken elsewhere in Europe focuses upon measures under the following headings (1) awareness raising and information, (2) assisting with business transfer planning, (3) seeking to deal with market failure by matching buyers and sellers, (4) financial support, (5) training within the support system and (6) tax policies.

■ The business support system – here and in the rest of Europe, public and private – is currently not as equipped as necessary to deal with the increasing volume and complexities of the business transfer market. There is a need for an accredited training programme for advisors to equip them with the skills and knowledge to adequately manage business transfers, and for private and public sector support to be better coordinated.

■ Support for business transfers has been developed but it is not necessarily reaching the right audience.

■ While the business transfer failure issue highlights the fact that there are too few buyers in the marketplace and that it is important to encourage more potential buyers to enter, the majority of support measures ignore the demand for businesses.

■ Most policies are concerned with mediating the change or transition, rather than whether the performance *after* transfer will be successful.

A(vii) Knowledge gaps

■ More information is needed if a firm basis for policy action is to be achieved. Reliable data relating to business transfer failure rates among small firms and the associated effects is not available and little is known about the post-transfer performance of firms. Information that allowed the differentiation between business failure and business transfer failure would be helpful in strategic decisions on targeting and scale of intervention required. The other main areas identified as research gaps are: spatial differentiation in the business transfer process; and the operation of the market in relation to small firms.

A1. Introduction

A1.1 THE LITERATURE REVIEW

This report has been prepared to inform the Government on the area of business transfer. Utilising the published findings from work undertaken by various organisations, including government departments, and academics (both in the UK and overseas), the study seeks to establish what is known about:

- (1) the extent to which there are barriers/problems facing small businesses seeking to affect a transfer of ownership;
- (2) the nature of these barriers in relation to different types of business;
- (3) the approaches that have been put forward as potential solutions, and their rationale; and
- (4) the forms of support which have been tried and their effectiveness.

The study is intended to build upon the research report *SME Ownership Succession*, prepared for SBS by Martin *et al.* in 2002, and offer an evidence base for policy-making. It focuses mainly upon smaller firms and transfer processes that apply to them; larger businesses, whilst not unaffected by succession or business transfer problems, represent a different category in relation to transfer and are less frequently affected by business transfer failure.

The literature on this topic is voluminous. Business transfer, which has a potentially important bearing upon the contribution of SMEs to the economy, has attracted much attention from academics over recent decades – interest reflected in (and encouraged by) the policy response at European Union level from 1994 onwards. This report is based on a general review of the literature, focusing mainly upon work carried out in the past decade or so, but with a particular emphasis on bringing together key findings from the most recent work.

Given the need for this study to contribute to the evidence base for policy action, we have given emphasis to publications incorporating empirical research and those that have relevance in the UK context. While evidence from abroad can help inform policy-making on business transfer, differences of tax and regulatory systems mean that direct

comparisons are limited. As will be shown in the following sections, while considerable understanding of the problem can be gleaned from the current literature, there are nonetheless significant gaps in our knowledge. These are identified as an integral part of the report.

Sources used in the preparation of the report are listed as References at the end; an annotated bibliography of substantive articles and reports is provided as a supplementary element within the evidence base (Section A2).

A1.2 DEFINITIONS

Business succession is the transfer of a small or medium-sized enterprise that results from the owner's wish to retire or to leave the business for some other reason. The succession can involve a transfer to members of the owner's family (who either run the business directly or indirectly by hiring managers), to the business's employees, or to external buyers.

From a policy perspective, the critical aspects of successful business transfer and succession failure can be summarised as follows (based on Martin *et al.*, 2002):

■ Succession failure – a situation where, other things being equal, the business either closes or is diminished owing to a poorly handled succession. A succession failure is different to a 'business failure' which refers to closure of the business because the business itself becomes unsustainable for any number of commercial reasons.

■ Satisfactory succession – when the transfer of ownership maintains or improves the performance of a stable or growing business, or positively turns around a poorly-performing business – through better organisation, investment, innovation, or leadership, for example.

In relation to family firms, a narrower definition of success also present within the literature incorporates 'satisfaction of the stakeholders with the business transfer process and outcome' (e.g. see Le Breton-Miller, *et al.*, 2004). To the extent that stakeholder satisfaction may impinge upon the ability of the owner-manager to achieve a transfer and upon the *subsequent performance* of the business (i.e. via motivation and effective family teamworking), this is a useful additional terminological consideration from a broader society/economy perspective.

It is important at this stage to distinguish between definitions of business 'closures', 'exits' and 'failures', since the terms are often confused and overlapping in the literature (Stokes and Blackburn, 2001). Throughout this review, 'closure' refers to discontinuance of the business, and 'exits' denote the end of an owner's participation in the business ('discontinuance of ownership') via gift arrangements, sale or closure. Business 'failure' refers to discontinuance of the firm through bankruptcy, excessive losses, or inadequate return on capital. Failed firms are to be distinguished from those experiencing 'business transfer failure', where closures include viable as well as unviable businesses.

A2. Ineffective transfer of business ownership

Business transfer failure represents a lost opportunity for new entrepreneurs. Rather than starting a new business, with all the associated risk, they can purchase an established business – and, possibly, benefit from mentoring support of the seller. The economy, meanwhile, benefits from the secured employment of the existing staff and the business continuing to supply its customers (SBS, 2003b). Poorly executed business transfer can also lead to losses for the economy – in terms of slower post-transfer growth, missed opportunities for achieving a new growth path etc.

This section summarises findings from the UK and overseas on the extent of unsuccessful business transfer, as measured in terms of the numbers/proportions of firms involved. It can be shown that the best available indications of the extent of the problem are flawed, and thus not especially helpful to the policy-maker. There are significant gaps in our knowledge on this issue. Ideally, the policy-maker needs data on business transfer outcomes and failures, in order to assess the existence/scale of any business transfer problem and make an assessment of the case for intervention. Data of this kind is not available from standard statistical series, and large-scale focused business surveys are really the only means by which business transfer aspects can be quantified – and even these approaches are accompanied by caveats arising out of methodological issues. The European Commission has observed that the absence of statistics on business transfers, particularly comparable statistics, make it difficult to appreciate the importance of the issue and has hampered the design of appropriate policies (Enterprise Directorate General, 2003).

A2.1 VULNERABILITY MEASURES

'Vulnerability' to business transfer failure has been the principal quantitative measure used to provide an indication of the scale of the issue. It yields figures of a magnitude that justify a high profile being given to the issue of business ownership transfer since the 1990s. This approach is based on the empirical finding that ownership succession is primarily related to age of owner (Martin *et al.*, 2002).

The expert group (drawn from all European Union member states apart from Ireland, Sweden and the UK), convened to carry out the 1994 Commission recommendation on support measures for business transfers, estimated that roughly one-third of all EU firms will change hands over the next ten years (ranging from 25-40% depending on the member state). This is the equivalent of 610,000 SMEs, potentially affecting 2.4 million jobs (Enterprise Directorate General, 2003). These orders of magnitude have been cited extensively in the literature on business transfer.

Vulnerability has supposedly been exacerbated by the nature of SME demographics (i.e. the bulge of businesses formed in the 1980s in the UK that are now 15-20 years old and have owners who are at, or approaching, the age when they will wish to exit). This gives rise to an understandable concern over the potential loss of viable businesses and related employment as the supply of firms coming up for sale exceeds demand (Blackburn and Stokes, 2002).

Using *Labour Force Survey* data, Martin *et al.* (2002) have shown that the proportion of owners with employees who had been in business for over five years and were aged over 50, and thus vulnerable to age-related succession or transfer issues, increased from 26.6% in 1992 to 35.3% in 2000 (the comparative figures for over 60 years of age were 8.7% and 10.3%). In 2000, the actual number of owners (all self-employed) in this position amounted to 63,000. Thus, around one-third of SME owners in Britain were identified as vulnerable to age-related transfer failure, and that this vulnerability affected an increasing proportion of the SME owners.

Similar findings have emerged from work undertaken in other countries and regions, as the following examples demonstrate:

■ **Germany (Baden-Wurtemberg):** 11-15% of all existing firms are forecast to experience ownership change over 2002-07 (Institut für Mittelstandsforschung, 2002).

■ **The Netherlands:** 17.4% of 'one-man business owners' were older than 55 in 2000, and the transfer of some 25% of all businesses is 'expected to occur' in the next ten years (80,000 businesses) – a figure which is supplemented by those businesses offered for acquisition for other reasons (early retirement through preference or illness, for example),

estimated to account for businesses covering 'at least 10% of total employment' (Netherlands Ministry of Economic Affairs, 2003).

■ **Austria:** It is estimated that approximately 25% of all existing businesses will face the challenge of achieving transfer of ownership in the period 2002-12 (Voithofer, 2002).

■ **USA:** The Small Business Administration has estimated that at any given time, 40% of US businesses are facing the transfer of ownership issue (Bowman-Upton, 1991).

■ **Australia:** The number of business owners aged over 50 (observed to be 30%) has shown a tendency to increase by about 10% per year since the 1990s. Thus, more and more new owners will be needed in 'ten years or so' (CPA, Australia, 2004), as an increased number of firms come onto the market.

On the basis of actual cases, Voithofer (2002) identified for Austria an upward trend in the number of business transfer cases. However, in spite of the widespread attention given to the ageing entrepreneurial profile, over the five-year period to 2001, the number of transfers in Austria prompted by reason of advancing age actually fell (by 5%). In fact, in 2001, some 52% of business transfers were ascribed to age (Voithofer, 2002), implying that, for nearly half the total, other influences are at work. This reflects the fact that factors driving the increasing number of firms facing transfer include an increasing number of entrepreneurs ('serial entrepreneurs') who remain in the same enterprise for a relatively short time, rather than for a lifetime, as was common in the past (European Commission, 2003).

Research based upon vulnerability measures indicates a general situation where an increased number/proportion of businesses is likely to reach the transfer stage, where the owner (or owners) will need to confront the choice of having to achieve a transfer (through market processes or family arrangements), or alternatively exit via closure of the business.

The weak association between such vulnerability measures and the actual scale of a 'business transfer problem' needs to be stressed:

■ Vulnerability measures may exaggerate the number of firms facing transfer in a particular period, because evidence on intentions suggests a fairly wide span of retirement age. Many owners do not have a fixed notion of when they will cease to work, and those starting their business nearer to retirement age tend to envisage a longer working life than their younger counterparts (Barclays 2001). While 24% of those who started a business when aged under 50 expect to go on working past 65, the equivalent figure for those starting a business when over 50 is 41%. In fact, of those starting a firm when they were over 50, nearly one-fifth do not expect to retire until they are *at least* 70.

■ At any particular time, firms with ageing owner-managers are far from being the only group vulnerable to closure. Many closures occur for reasons other than age/retirement. For example, evidence from the USA shows that closures among relatively new firms is relatively high (around 50% exit by year four), but this is not necessarily an indication of business 'failure'. Around a third of the business closures are 'successful' at that point; the change was simply occasioned by the owner's wish to move on to a new opportunity (Headd, 2003). Further, as noted above, recent research relating to Austria suggests that only just over half of business transfers are prompted by age-related factors. Data on age of transferors in Baden-Wurttemberg (Institut für Mittelstandsforschung, 2002) shows only 35% were over 60 years of age, with 17% exiting before the age of 50 and 48% in the age bracket 50-60.

■ Vulnerability measures relate only to the supply side of the issue (i.e. the supply of businesses for transfer, increasing via the market); they offer no indication of the situation on the demand side (the number of potential transferees). The supply-demand relationship is an important determinant of the incidence of 'business transfer failure', which is the key measure in assessing the losses incurred by the economy and thus the potential gains from intervention.

Vulnerability measures are best regarded as crude warning signals of a potential problem. They can tell us very little about the actual presence of a 'business transfer problem' or indeed its scale – a significant research gap. Thus, the estimate of 54,000 small firms in the UK 'at risk of business transfer failure' (Martin *et al.*, 2002), may represent an overestimation of the number of firms actually reaching the business transfer stage for reasons of age. Moreover, that figure of 54,000 leaves completely out of account the very considerable numbers of firms owned by people in non-retirement age brackets who will be seeking to exit their businesses at any time (either for health, early retirement or other reasons). Furthermore, whatever the figure turns out to be, a business transfer 'problem' only exists where effective demand for businesses is below the level of supply of viable concerns.²

² It should be added – though it is a further complication in respect of estimating the likely number of businesses reaching succession stage – that the demand-supply conditions themselves also influence owners' decisions regarding the timing of exit.

A2.2 INTER-GENERATIONAL SURVIVAL OF FAMILY FIRMS

Data from studies relating to different countries confirm that few firms survive through inter-generational transfer. This pattern has been ascribed to various factors, including the educational and independent career aspirations of the offspring of entrepreneurs (Bachkaniwala *et al.*, 2001), and the structural shift from manufacturing to services, which is found to be characterised by more mono-generational businesses (CPA, 2004).

The inter-generational transfer pattern in this country corresponds closely to that found in other countries. Research undertaken by Stoy Hayward Consulting/London Business School (1989) found that only 24% of family businesses were transferred to the second generation, and just 14% to the third.

Australian research shows that only 11% of family owned businesses survive (within the family) to the third generation, and just 6% to the fourth (Smyrniou and Romano, 1994, quoted in Westward, 2003). Work on the survival rates of businesses in the USA suggests that only 30% of firms survive into the second generation of family ownership, and 15% into the third (Kets de Vries, 1993).

Research from the UK also shows, however, an increasing chance of survival within the family with each inter-generational transfer. While 24% survived to the second generation, 50% were passed on to the third and over 70% to the fourth (Greenwald and Associates, 1993, cited in Bjuggren and Sund, 2002). As an explanation, it has been suggested that firms that have already experienced a transfer will benefit from organisational learning (Davies and Harveston, 1998, cited in Westhead, 2003; Schulze and Dino, 1996, cited in Bjuggren and Sund, 2002), and be more aware of the need to plan for a transfer. However, the findings of Sharma *et al.* (2000) question this view. They found that, even large firms managed by second or third generation family members, and who have experienced the difficulties of business transfer and seen the advantages of planning, did not consider that their firm was giving the issue sufficient importance.

In fact, the indications are that, as time goes on, more and more ownership transfers are taking place outside the family to third parties (see e.g. European Commission, 2003). This is suggested by findings of research undertaken in Germany, based on a survey of 320 companies of diverse size, sectoral and

ownership characteristics (Institut für Mittelstandsforschung, 2002). Firm responses showed that the proportion of *actual* business transfers from within the family during 1997-2002 (75% as opposed to 17% to external parties) is substantially higher than the proportion of companies *intending* to transfer to younger family members over the period 2002-07 (51% compared to 43% to external parties).

Research findings relating to Austrian businesses over the period 1993-2001, provides more rigorous support for the notion that the number of business transfers taking place outside the family is increasing. By 2001, 31% of Austria's business transfers were to new owners outside the family³, usually *via* sale arrangements (Voithofer, 2002).

What is the significance of these findings? In the first place, it should be stressed that failure to transfer *within the family* should not be equated with *business transfer* failure. Some research appears to interpret the inter-generational data in this way, in spite of the fact that many businesses that do not find a successor within the family continue to operate through being transferred to an owner from outside the family. Bjuggren and Sund's view (2002), that 'low frequency of intergenerational transfer is a problem', is based upon their ascribing particular competitive advantages to a family-run business over those owned or managed outside the family. There is some evidence to support this view: Dunn (1996), for example, demonstrates advantages of family firms in her analysis of performance over time, showing that larger family firms do better in terms of share values, than non-family firms. It is also the case, however, that there are potential benefits to transferring a business to efficient owner-managers from outside. Unfortunately, there is no systematic study of post-business transfer performance available to throw further light on this issue (see section A2.4).

Secondly, an important implication arises from the trend towards transfers outside, rather than within, the family. This proportional shift, especially when taken in combination with the rise in the *number* of business transfer instances or opportunities, gives an increasingly important role to the market for firms. The capacity of that market, and the efficiency with which it operates, is of growing significance among factors determining the level of business transfer failure within the economy.

³ The original proportion (relating to 1993) is not recorded in Voithofer's short paper (2002) nor in the more detailed report by Mandl (2004).

A2.3 BUSINESS TRANSFER FAILURE

Survey-based research focused upon businesses which recently closed, undertaken by Stokes and Blackburn (2001), helps to throw light upon the *actual scale of business transfer failure* in the UK. The Kingston University study was based on data for 1999 derived from 388 firms drawn from right across the sectors and size range, and including a large proportion of micro-businesses. Identifying and contacting proprietors whose businesses have closed poses considerable practical difficulties for researchers, and this study is thus one of the very few which provides data on the issue.

Of the total number of cases, 17% were classified as 'technical closures', in that they subsequently re-opened in a different form (e.g. switching from sole traders to limited company status). A further 34% of exits involved the 'selling-on for a consideration' of the business (either to family or external purchaser), some of the external transferees absorbing the assets within a larger enterprise. On the basis of this study, therefore just over half (51%) of all the owner exits investigated appear not to involve outright closures of the business and cessation of its activities.

Of the other half (49%) of owner exits, approaching two-fifths (36% of these and 18% of all cases) were associated with financial failure (insoluble financial problems, often leaving bad debts), and recorded as 'liquidated'. The authors point out that this figure, for technical reasons, over-estimates the true proportion of insolvent firms. Given their financial problems, these businesses must be regarded as 'business failures' rather than 'business transfer failures'.

The final category consisted of the 31% of the firms 'closed down' by their exiting owners. Since the category was made up of businesses no longer meeting the owners' objectives, but without significant debts or financial problems, these firms are the ones that most closely conform to the category of 'business transfer failure'. This figure might be something of an underestimate, to the extent that (as noted above) some of the closed firms counted as 'liquidated' were not genuinely insolvent. On the other hand, the inclusion in the Kingston survey of some closed firms with turnover levels below the VAT threshold is likely to have worked in the opposite direction, raising the rate of business transfer failure (given the greater vulnerability to business transfer failure of small firms, discussed below, section A5.2).

The only source of comparison available would seem to be from Austria. Work undertaken at the Austrian Institute for Small Business Research (AISBR) led to the conclusion that 18% of possible business transfers were not achieved during 1993-2001 (Voithofer, 2002). The AISBR figure for 'business transfer failure' was derived from the Institute's business transfer model which (1) adjusts age profiles of owners according to proportions of actual transfers by age (to allow for early/late retirements); (2) applies financial criteria to identify the businesses unlikely to be attractive to a buyer; and (3) excludes both larger firms (250 or more employees) and one-person businesses (transfers of which, the researchers argue, in many respects resembles a start-up) (Mandl, 2004). Through these means the Institute produces a figure for the 'number of realistic business transfers', and it is the failure to achieve ownership transfer of these viable businesses that is used to determine a business transfer failure rate.

Applying these two estimates (18% and 31%) to UK firms' data, suggests (very tentatively) that business transfer failure accounts for between 28,000 and 46,500 out of the 155,000 'closures' (based on VAT deregistrations) in England in 2002. This is equivalent to a range of below 2% to 3% of the stock of VAT registered businesses (and compares to an average annual overall closure rate of around 10%). In point of fact, the actual number of businesses (VAT and non-VAT registered) is around 4.1 million. With a closure rate among the smaller firms likely to be higher than 10%, the rates used lead to the distinct possibility that over 100,000 businesses per year may be affected by business transfer failure. It must be stressed that there are many caveats associated with the use of these figures, and it should be recognised that the large majority of these 'failures' will consist of one-person businesses. However, in the absence of better data, these crude estimates offer some guide as to the number of firms in Britain which fall victim to business transfer failure.

A2.4 POST-BUSINESS TRANSFER PERFORMANCE

Another important aspect of the business transfer issue relates to success (i.e. survival and growth) of firms in the post-transition period. We have been able to discover little information on this in the current literature covering small firms. Some highly specific work has been carried out, such as that by Bailey and Helfat (2003) showing that external successors who have within-industry experience are associated with less variation of firm performance than those with just related-industry skills. Morris *et al.* (1997), in a study of over 200 second and third generation businesses, found that *smooth* transitions within the family do not necessarily result in better post-transition performance by the enterprise; implying that messy transitions are just as viable in the longer run.

Austrian data would appear to offer the only reasonably systematic measure within the literature of post-transfer 'success' rates. Of those firms that were transferred in the early-to mid-1990s, the AISBR study showed that 96% were still in business five years after transfer took place – although some 14% of the post-transfer firms reportedly were 'facing business difficulties'. The remaining figure of 80% still constitutes a performance that is very positive overall – particularly if set alongside the survival rate for new start-ups over five years (which the Institute finds to be 75%) (Voithofer, 2002; Mandl, 2004).

Interestingly, the AISBR research also showed that, in addition to recording higher survival rates, those businesses with a transfer plan exhibited a higher rate of post-transfer sales growth than those with no plan.

The Austrian research represents best practice in terms of monitoring business transfer, both prior to transfer and afterwards. It is unique in providing survey-based evidence that informs policy-makers on the transfer process and its outcomes. In particular, it permits the relative success of different transfer mechanisms and successor types to be identified, and the relationship between these and subsequent performance, thus informing future policy action. This facility is not available to UK policy-makers, and thus constitutes an important research gap.

A3. Wider economy perspectives on business transfer outcomes

Accurate measures of overall business transfer failure are a pre-requisite for measuring its impact on employment, productivity, output, etc. For the measures to be robust, they need also to include information on post-closure 'resource use', i.e., the redistribution of human or physical capital.

In the previous section, the problems of identifying businesses 'at risk of business transfer failure' were discussed. This work suggests that quantifying the impact of business transfer failure using vulnerability measures is of doubtful value, despite this being practically all that is available to policy makers in the UK.

Given the absence in the literature of any serious attempt to measure quantitatively the impact of business transfer failure, this section responds to this research gap by drawing attention to the *kinds* of effects associated with different business transfer outcomes. The observations contained in this section, whilst necessarily largely qualitative in nature, are nevertheless important considerations from the perspective of policy-making. The section identifies the special significance of business transfer outcomes in relation to dynamic aspects of the economy.

A3.1 AVAILABLE ESTIMATES OF IMPACT: PARTIAL AND UNRELIABLE

It has been shown in section A2 that only very crude estimates are available of the scale of business transfer failures and their impact. The one million people working for the 54,000 UK businesses estimated to be 'at risk' of business transfer failure by Martin *et al.* (2002) is thus a misleading measure of potential employment losses. Methodologies deployed by those contributing to the official literature relating to business transfer are far from rigorous: e.g. the scaling down to national level of the EU-wide estimate that 'at least 10% of all business failures... are caused by poor or completely non-existent planning for succession'. Apart from criticisms related to how the 'at least 10%' figure was arrived at, such measures are ambiguous in terms of the losses due to transfer failure of financially viable businesses. They also fail to quantify the losses to the economy resulting from factors like:

■ from slow post-transfer growth resulting from *poorly planned and executed* (as opposed to failed) transfers, or

■ businesses which achieve 'successful' transfer to a new owner, but subsequent fail and close down.

From a policy perspective, it is unfortunate that the literature provides very little by way of insight into post-transfer performance (whether measured in terms of profitability, output, productivity or employment). Most of the research of this kind relates to CEO change in large rather than small firms.

A3.2 EXIT AND CONTINUED AVAILABILITY OF ENTREPRENEURIAL SKILLS

It should be stressed that not all business closures should be categorised as 'failures'. Businesses may close, but more than six out of every ten owners exiting from a particular enterprise actually continue to use their entrepreneurial skills. Research carried out on 'serial entrepreneurs' has led to a more positive attitude within the literature towards closures, leading to a questioning of the relationship between closure and 'business failure' (Stokes and Blackburn, 2001). It is no longer automatically assumed that closures represent unsuccessful business ventures; their contribution is more generally viewed within the dynamic framework of Schumpeter's 'creative-destruction' concept. 'Survival' is thus not especially useful as a proxy for success, since it does not capture firms where the owner's *strategy* includes exiting from the marketplace (Headd, 2002).

The subsequent activities of owner-managers who exit a firm were investigated in the survey-based study of Stokes and Blackburn (2001). They reported that the owners fall into the following types:

■ those who became employed, unemployed or out of work through ill health (29%);

■ those who retired from active involvement having sold or closed their business (9%); and

■ those who returned to continue as a business owner by opening or buying a new or similar business to the one closed/sold-on, or through the existing ownership of another business (62%). This element comprises:

- 9% actually continuing the business in a different form;
- 20% continuing to run other businesses;
- 18% starting a similar business; and
- 15% starting a new business.

From the perspective of the stock of entrepreneurs, therefore, business transfer failures (and many closures of unviable operations) do not imply significant loss in terms of the availability of these resources and functions within the economy.

A3.3 CLOSURES WITHIN A DYNAMIC ECONOMY

Closures play a crucial role within the economic restructuring process. The evolution of the economy along a path of rising competitiveness and growth requires that, in any period of time, a proportion of firms cease to exist. Sectors in which the domestic economy is no longer competitive will contract, and even disappear, in the process freeing resources for the establishment and expansion of new activities where the demand for the products/services is growing (see e.g. Voithofer, 2002). Research shows that rates of exit vary with the business cycle far less than corresponding rates for entry; and less also than between different industries and regions (Callejón & Segarra, 1999). Closures seem to occur at a fairly steady rate, rather than a rash of them associated with cyclical downturns in trading conditions. This implies that business transfer problems are not concentrated in periods of recession.

Numerous studies have addressed the issue of 'churning', and the resulting effects in terms of productivity growth. High rates of both firm births and deaths are a feature across all industries and territories. Annual turnover in manufacturing units varies from nearly one-fifth to over a quarter of total stock, according to the country studied (see e.g. Disney *et al.*, 2003; Callejón & Segarra, 1999; and Roberts and Tybout, 1997). The bulk of businesses are small in size, and thus the churning effect is largely concentrated among SMEs, especially micro-businesses. Consistent with this picture, the AISBR database shows that nearly two-thirds of potential transfers concern firms with less than five employees; only 3% are medium-sized (50-249) (Mandl, 2004).

Findings from the extensive research on churning confirm empirically that the process has a positive effect upon long run performance of industries. In the short-term, the productivity effects of business turnover are modest, because the new plants that come on stream are only slightly more productive than the ones they replace – and both are typically small. Over a period of years, however, new firms that survive tend to record higher productivity gains, while many of those which exit are typically on a downward trend of productivity and thus would have pulled down sectoral efficiency if they continued in operation. Surviving firms which expand, however, also make an important contribution to productivity growth (Disney *et al.*, 2003), and some of this may be lost if viable firms exit unnecessarily through business transfer failure. In the absence of empirical evidence on post-transfer performance it is difficult to determine the long-term outcome in terms of output, productivity and employment of new start-ups versus firms that survive through ownership transfer. Austrian data shows that a successor, on average, safeguards four jobs, while more than half of start-ups are single-person operations. It would be helpful from a policy-making perspective to track the performance of a transferred business over a period of time. The resulting information would help in determining the appropriate balance of public support allocated to start-ups as opposed to business transfer support.

While closures are important to the health of a dynamic economy, this cannot be said of business transfer failures, which involve firms that are financially viable in at least the medium term. From an intervention perspective this indicates the need for wariness, given the need to avoid supporting business failures and to seek ways of ensuring that business transfer failure does not deprive the economy of viable businesses. The market can normally be expected to ensure the survival of viable firms that are facing business transfer, except where conditions of market failure apply.

A3.4 SPATIAL VARIATION OF IMPACT

Martin *et al.* (2002), based upon investigation of just three regions, draw attention to the fact that age-related business transfer poses a greater threat to some regions than others. In the East Midlands, the increase in the proportion of vulnerable owners (from 27% to 45% between 1992-2000), was well above the UK figure of 35%. The North East vulnerability figure, for instance, was found to be similar to that of the UK. However, it may well be that breaking down

the regional figures to sub-regional level might well yield similar discrepancies to that shown with the East Midlands.

The spatial aspect of business transfer constitutes a research gap. It would be valuable in terms of policy-making to extend the spatial analysis to capture business transfer failure and its effect in different localities. The dynamics of business change vary significantly between different types of local economy. The South East of the country is largely characterised by a high proportion of the working population engaged in entrepreneurial activity, buoyant trading conditions, widespread shortages of property, labour and skills, and relatively high borrowing power based on available collateral. This could be predicted to increase the chance of ownership transfer to outsiders; but even if this were not the case, rapid re-deployment of the facilities and resources released by the closure of a business is likely. In such circumstances, it is likely to be pointless and, possibly actually misleading, to measure the potential losses (output and jobs) associated with businesses vulnerable to business transfer – even were they to be accurately measured.

The same argument may not apply, however, in relation to vulnerable businesses in run-down and disadvantaged communities – such as those in parts of the North East. Low levels of entrepreneurship, weaker demand conditions, poor collateral, surplus industrial property etc. in such areas would be likely to give rise to wholly different implications in circumstances of business transfer failure, especially for firms where the market for their sale is highly localised. Failed business transfers of potentially viable businesses in areas of high unemployment and low activity rates thus involve much higher social costs (including Exchequer costs) than is the case in more economically buoyant geographical areas, especially when the impact of their closure upon other local firms, regeneration etc. is taken into account.

Similar arguments could be made in relation to firms facing business transfer that are located in remote rural areas. The highly localised nature of the market for small firms poses particular problems for such businesses, and business transfer failure can deprive local consumers of a valuable service – leaving alternatives that cost more and/or are less appropriate to local needs. This concern for the implication of business transfer problems for specific locations is echoed in the Austrian context, where it is recognised

that in 'outlying and border regions' in the event of business transfer failure, employees find particular difficulty in finding alternative employment (Mandl, 2004).

A3.5 BUSINESS TRANSFER AND BUSINESS DEVELOPMENT OPPORTUNITIES

Business transfer events can be the opportunity for the adoption of new business practices, processes and technology, as well as improvements in organisational culture, redirection of marketing strategy etc. Such innovations can be the basis for business development, leading to improved growth and financial results. Recognising the importance of external networking and business-to-business links etc. to firms' competitiveness, the potential advantages of an injection of new ideas and contacts via succession to a new owner manager (or management team) from outside the business can be understood. It is possible that such a transformative effect can accompany the transfer of the business to a family member, but it is important to recognise that the original owner is a key figure in the selection of a successor, and qualities valued may not be those interested in or suited to transformative action (Martin *et al.*, 2002). Moreover, the chances of a successful transfer increase with the similarities between the skills and style of the old and new entrepreneurs (Netherlands Ministry of Economic Affairs, 2003)

Hadjimanolis and Dickson (2000), on the basis of work carried out in Cyprus, show that business transfer is connected to business innovation because of the ideas and opportunities for change that it brings. This is termed a 'development response' by the successor, whether family member, external manager of purchaser. They argue that there might also be:

- a 'proactive response' (where funds from the sale of one firm are utilised to establish a higher-technology business); or
- a 'reactive response' (where recognition of the low value/saleability of the business in the approach to business transfer encourages the owner to consider new products/services and processes).

It has been suggested that the 'proactive response' may be used to address the well recognised business transfer issue relating to ethnic family businesses – i.e. the nature of the present firm is not attractive to younger generation family members when considered alongside the status and rewards from professional career opportunities (Martin, 2002).

There appears to be little evidence about post-transfer firm performance that supports, or has tested, propositions of the kind outlined above. There is some work, however, suggesting that management behaviour conforms to theoretical expectations. One source reports that some 60% of transferees introduced a 'different business model' on taking over control (Institut für Mittelstandsforschung, 2002), adding that such action appears to be more in evidence where an outside party has taken over the reins (70%) than in cases of transfer within the family (55%). According to this study, only one in seven transferees appears to have left things unchanged; more than 60% having changed the business plan, introduced new products, specialised, or changed size of the operation.

The above discussion focuses upon performance of the business where it remains an ongoing entity under new ownership. It should be noted, however, that external purchase that resulted in the incorporation of the business as an integral part (or division) of a larger enterprise might give rise to similar performance improvement, through, for example, new investment capability, transfer of technologies etc.

Not all research is positive about the potential benefits of such a change actually being delivered. While recognising the potentially positive impacts upon company performance, Dutch economist A. van Witteloostuijn (Netherlands Ministry of Economic Affairs, 2003) stresses the things that can go wrong. Echoing an important theme in an ongoing debate in management literature, he points out that:

“...despite all the consultant, management and guru babble on the matter, leadership and organisational change have a persistent tendency to lower company performance than improve it. Precisely in business transfers, there is a high risk that an accumulation of changes will be introduced: not only is one entrepreneur replaced by another, but the newcomer has a strong tendency to launch a series of 'challenging' organisational changes (p.7).”

A4. Obstacles to effective ownership transition

Two recently published pieces of work (relating specifically to family-owned businesses) provide updated and competent attempts to draw together, from a voluminous but fragmented literature, the main elements which are significant in the business transfer process, and the way they interact to influence transfer outcomes (Le Breton-Miller *et al.*, 2004; Dunemann and Barrett, 2004).

Le Breton-Miller *et al.* conclude from their review of research that (1) the attributes of the incumbent owner-manager and the successor, and their relationship, constitute a vital aspect of the business transfer process, and (2) certain 'ground rules' are necessary if successful transfer is to result. Their focus is largely 'internal', so this section will discuss key aspects of the issue of business transfer within their framework. It will then proceed to draw attention to the way that 'external' influences impinge upon the business transfer process (e.g. the operation of the market in firms, financial and tax issues).

A4.1 KEY INTERNAL FACTORS

A4.1.2 Incumbent owner-manager

Business and family relationships. While all businesses operate within a web of institutional and personal relationships, this is particularly the case as far as family businesses are concerned, where relationships are often especially complex and exert a significant influence upon decision-making. Hence, it is widely recognised that relationships are critical to the succession process (Bachkaniwala, 2001). While each situation is plainly unique, the literature indicates that there are some features of those relationships that frequently arise in relation to succession.

A vital relationship is that of the incumbent leader (owner-manager) and his/her successor (Fox *et al.*, 1996; Cabrera-Suarez *et al.*, 2001) – as reflected in the work of numerous researchers during the 1980s, who report a positive link between the quality of the relationship and succession outcome (e.g. Ward, 1987, cited in Le Breton-Miller). Some researchers report that, even where formal succession procedures are poor or non-existent, the alignment and consistency of value systems between incumbent and successor is often sufficient to facilitate a viable transition (Garcia-Alvarez, 2003,

cited in Dunemann and Barrett, 2004). A relationship of mutual respect and trust is found to be important to the effective transfer of knowledge between generations or to a successor from outside the family. The relationship of the incumbent and successor with other stakeholders in the businesses, including key employees, is also important to succession outcomes (Fox *et al.*, 1996). The avoidance of poor communication between the different individuals involved in the succession process is emphasised in the literature as a means of overcoming the problem of 'negative emotions' that are often present (Dunemann and Barrett, 2004).

Personality, motivation and incumbent needs.

Many investigators stress the importance of the incumbent being able to overcome anxiety concerning succession, so that they can confront the issues associated with losing control, power and adjusting to a change in their identity. The inability of an owner-manager to 'let go' of the business is recognised as a significant obstacle to effective succession (Sharma *et al.*, 2001). At the same time, the incumbent has to make what can be emotionally taxing decisions concerning who shall do what in the future business.

Particularly important is the incumbent's ability to delegate and allow the successor to take decisions – since this is a vital part of developing as a successor. Factors inhibiting such an approach – including incumbents wanting to control every detail of the firm – are explored by Barach and Gantisky (1995). They stress the importance for effective succession of incumbent attitudes that embrace cooperation, encouragement and openness to new ideas.

Available data on the proportion of owners who have an active role in the business following transfer suggests quite a substantial continuing involvement. Some 41% of previous owners of transferred firms were still involved with the firm after a year and 26% after five years. The authors point out that such arrangements were not only reported by 75% of the successors to be positive in terms of smoothing the hand-over process, but suggest that they may have helped in encouraging the owner to hand over the reins (Mandl, 2004).

A4.1.2 Successor

Abilities and motivation. A successor needs to be able to demonstrate skills and experience in relation to those needed to lead the organisation in order to gain credibility and legitimacy in the new role (Barach, 1995). Evidence for this is provided in research undertaken specifically into successors by Chrisman *et al.* (1998, cited in Le Breton-Miller), whose survey of nearly 500 owner-managers found decision-making experience and interpersonal skills were among the most important of attributes. Le Breton-Miller cites a range of sources that stress the importance of commitment on the part of the successor in the success of the transfer. Based on an empirical study, Shepherd and Zacharakis (2000) conclude that the most successful handovers are those where the successor has both financial and behavioural sunk costs in the enterprise (i.e. they have invested both their own time and money) and feel that they have 'earned the right' to be leader.

Career development and preparation for leadership role.

This is found (e.g. by Ward, 1987) to be one of the most important factors in cases of successful transfer of family-owned businesses. Effective successors are found to have more years of appropriate experience within the family-owned business than less effective ones (Goldberg, 1996, cited in Le Breton-Miller); lengthy involvement with the family-owned business allows the successor to become familiar with the business, its culture and values, and to build relationships with employees, establish credibility and develop capabilities of relevance to the firm. To smooth the handover process, the successor manager should work alongside his predecessor for some time, possibly jointly running the company, for a period of up to several years (Netherlands Ministry of Economic Affairs, 2003; Institut für Mittelstandsforschung, 2002). In the UK, only 30% of firms use a mentoring scheme for future successors to any extent (Grant Thornton, 2002). Full induction of a successor can even overcome the problems for transition posed by the highly idiosyncratic management systems and processes commonly found in family businesses. It should be noted, however, that there is evidence in the literature that gaining experience outside the family firm is also an important ingredient of success (Ward 1987), given its potential gains in terms of building knowledge, self-confidence and imparting credibility, etc.

A4.1.3 Establishing rules and guidelines for business transfer

Business transfer planning. Failure to plan for transfer is a major cause of business transfer failure. Mandl (2004), for example, finds it is one of the three key factors associated with business transfer failure in Austria. The strong message from the literature is that this process must be started well in advance of the event – indeed, the European Commission (2002) recommends that the preparation should commence as much as 5-10 years in advance. Risak and Nagy (1999) meanwhile have found a positive correlation between planning duration and the success of the business transfer. Ideally, therefore, planning for ownership transfer should include provision for a phased hand-over, perhaps over a period of years, as authority and responsibility moves to the successor and mentoring arrangements are put in place to nurture the new generation of family managers (Le Breton-Miller *et al.*, 2004). Capital transfer arrangements need to be made in parallel with leadership transition, so as to ensure the new owner does not have to operate in conditions of unreasonable financial pressure (Grant Thornton, 2002).

The point has been made earlier (section A2.4) that post-business transfer performance is important in understanding business transfer successes. Interestingly, the AISBR research also showed that, in addition to recording higher survival rates, those businesses with a transfer plan exhibited a higher rate of post-business transfer sales growth than those with no plan.

Shared vision. The quality of the family relationship is shown empirically to be more significant as a predictor of successful transition than either business transfer planning or the preparation of successors. For example, in a study of second and third generation firms, Morris *et al.* (1997) found that while transitions occur more smoothly where heirs are better prepared, relationships between family members are more trust-based and friendly, and when the business plans carefully in relation to taxation and wealth transfer issues, the greatest single impact on successful transitions was identified as relationships within the family. Barach and Gantisky (1995), Chrisman *et al.* (1998), and Sharma *et al.* (2001) are among the many researchers who conclude from their work that sharing views on the goals of the business is essential to effective business transfer. Sharma *et al.*, 2003 stress the importance of 'aligning perceptions and expectations

that each individual has about the conduct of the succession process' (p.667). It is commonly suggested that this vision can be encapsulated within a 'relationship charter' or family constitution.

Family acrimony can be a major cause of transfer failure, especially among the many firms without external board members. Janjuha-Jivraj and Woods (2002) argue that such family tensions are especially rife among ethnically owned businesses, and that family splits and inter-generational attitudinal differences contribute to business failure in this group. The potential value of family councils needs to be considered in this context; while they have long been recognised in the family-owned business literature, according to Le Breton-Miller *et al.* (2004) their potential value as a mechanism to assist with the business transfer process has largely been ignored.

From an empirical study of 170 SMEs, Wang *et al.* (2004) conclude that the keys to successful family transfer are trust and affability, harnessed to formal planning and an open and entrepreneurial attitude on the part of the owner-manager, and the use of all possible avenues of support. 'Enablers' in this process can range from independent board advisors and outside financial experts to family counsellors and even family members not involved in the business. Such support contributes to the transparency of the process and makes it more inclusive to all relevant family members (Burke, 2003; Janjuha-Jivraj and Woods, 2002).

Selection of successors. The literature is comparatively thin in respect of the attention given to the aspects of selection and development of successors (Le Breton-Miller *et al.*, 2004). There are a number of important issues that arise, including the need for the selection to be seen as something which is often best undertaken over a considerable period of time, and may also entail identifying and then grooming for the job not just a single successor (the CEO), but a management team. Another important consideration is the extent to which selection processes lead to the identification of a 'safe pair of hands', or person whose main virtue is the ability to work with the existing owner-manager and workforce, over an individual (or team) with ideas and ambition to develop the business through introducing new methods and innovations (see section A3.5). Information derived from the AISBR relating to successors and their origins shows that the selection process may be assisted by the fact that more than

seven in every ten business successors are found to be already actively involved in the company at the time of the transfer. A large proportion of successors thus have not only relevant industry experience but also direct knowledge of the firm itself. Interestingly, only 6-8% were found to have already been entrepreneurs (Mandl, 2004). Because of our research gap in relation to successor characteristics and post-business transfer performance, it is not possible to confirm that a similar situation to Austria applies in relation to the UK.

A4.2 EVIDENCE FROM RESEARCH ON OBSTACLES TO TRANSFER

In addition to the 'internal' attributes and characteristics of the owner-manager and their successor, there are a number of other obstacles, both internal and external, which can reduce the chances of successful business transfer. These overlap, to a degree, the attributes outlined above, placing the firm within its wider context of sector, financial performance, strategic management, specific policy areas etc., and including aspects of transfer which are outside the immediate control of the owner-manager or their successor.

A4.2.1 Lack of business transfer planning

Lack of business transfer planning is the factor most commonly identified as the main contributor to business transfer failure. Results from the Grant Thornton survey of UK firms (2002) revealed that only around half of family-owned businesses intended to activate a business transfer planning process five years before their planned retirement. Further, Grant Thornton show that formal planning business transfer guidelines (such as the formulation of a family constitution and use of mentoring scheme to nurture the new generation of family managers) are not widely used – e.g. only 6% were found to make significant use a family constitution (Grant Thornton, 2002).

In a number of different recent surveys covering the USA, Australia, Europe and Britain, a strikingly similar proportion of managers – around two-thirds – report that they have made no formal plans for business transfer or exit (Cliffe, 1998, cited in Westhead, 2003; Barclays, 2002; Blackburn and Stokes, 2002; Kirby and Lee, 1996; CPA, 2004; Voithofer, 2002; Dunemann and Barrett, 2004). There is also the possibility that this may even be an underestimate of preparedness, and that managers may be exaggerating the degree to which they plan for the future: in an Australian survey, 41% of small

businesses reported that they had documented strategies for the future, while accountants estimated the incidence at the much lower figure of 16% (CPA, 2004).

Although there is a slight increase in the proportion with business transfer plans as the age of the owners increase, this is not particularly marked: in the 60-64 age bracket it is found that 60% of owners still have no definite plan (Blackburn and Stokes, 2002). Perversely, research by the Bank of Scotland (2004) shows that it is the younger business owners who are most likely to have a written plan in place – 36% of those under the age of 45 have such a plan, compared to 18% of those aged over 56.

In terms of the size of the firm, there is some evidence that the larger the firm, the greater the likelihood that there is some form of business transfer planning. In a German survey, a slightly higher proportion of firms with 20 or more employees had made provision for the sudden departure of the owner than smaller firms (50% and 40%, respectively), while the equivalent figure for sole traders is just 20% (Institut für Mittelstandsforschung, 2002).

A survey for Barclays Bank (2002) suggests that, in any cross-section of family businesses, 30% of owner-managers will be found to not even have made a will. Completely unforeseen exits are not uncommon – Voithofer (2002) estimates the proportion is 9% of all business transfers, the Institut für Mittelstandsforschung (2002) puts the proportion at 15%. According to Morris *et al.* (1997), only a third of businesses survive the loss of the founder-entrepreneur, and this proportion will rise, the more unexpected is the transfer (Institut für Mittelstandsforschung, 2002).

A4.2.2 Lack of family successors

Increasingly, family-owned businesses are being transferred outside the family. In a rising number of cases, it appears that children have no desire to take over traditional family businesses. Bachkaniwala, Wright and Ram (2001) argue that this trend is particularly acute among Asian businesses. Only 21% of Australian small business owners felt that their children were both willing and able to take over, despite the fact that to pass on the business within the family seems to be the preferred option for the majority of owners (CPA Australia, 2004). Results from the Grant Thornton/Manchester Business School survey (2002) confirm that this is also the

situation in the UK. They report that, while passing on the business to the next generation was much preferred to an external sale or management buy-out/in, a lack of family interest or of requisite management skills operate as an 'extensive constraint' to achieving this in nearly a third of businesses. Almost one in five respondents reported problems of lack of interest in taking in the business on the part of heirs. Casson, Jennings and Allen (2003) point out, however, that lack of interest from family members may not always be a disadvantage, since one of the key factors in successful transfer is a small, focused management core (family or non-family). In other words, the involvement of an *extended* family, lacking knowledge, skills and experience relating to the firm, can dilute this focus.

A4.2.3 Deficiencies in market for firms

Although external transfer is often the second-best option for family-owned businesses, in the absence of a business transfer plan, many small businesses must resort to locating a potential buyer when the decision is taken to exit. It is recognised, however, that this option is far from straightforward: 'succession from outside is more difficult at almost all stages than succession from within the family' (Institut für Mittelstandsforschung, 2002). The major problems are finding a successor in good time, and successfully managing the handover period. The owner-manager faced with having to sell in the market risks having to close the business if no successor can be found, or to sell at an artificially low price in order to realise any financial return for the business as a going concern (as opposed to simply its assets).

The market in firms is very active and has developed significantly over the past decade or so. Grant Thornton's survey-based report (2002) shows that around one-third of firms' owners seek to exit via a trade sale, with around a further 10% seeking ownership transfer via the management buy-out/in route. Exit via the market is understandably favoured by non-family owned companies (Grant Thornton, 2002), but owners of 'saleable' SMEs with a value of £250,000 to £3 million can readily dispose of their businesses through accountants and company brokers acting as specialised intermediaries – though mostly to large enterprises seeking to build market share or gain economies of scale, rather than entrepreneurs (Martin *et al.*, 2002). For most family firms – even small ones – trade sales are also the most common means of disposal to a third party

(Harvey, 2004). Martin *et al.* (2002) point out that a number of trade and occupation-based micro and service based enterprises sell their businesses through business transfer agents, who advertise the business and bring buyers and sellers together for 'what is often largely a property-based transaction'.

The market has its operational deficiencies, however. The absence of any comprehensive, unified database or marketplace in the UK is an obstacle to finding a buyer, especially for smaller firms. While exploiting trade contacts, or using of specialist business transfer agents may alleviate this somewhat, the active market is often limited in scope for many firms. Except where property assets are key to the sale (e.g. newsagents, restaurants), small firms find more difficulty in finding a firm to operate on their behalf (Harvey, 2004). There is a special problem for firms where the founder's knowledge and networks are important and are not regarded as saleable. In Australia, 30% of managers believed it would be difficult to find a buyer, with the proportion higher at the smaller end of the market (CPA Australia, 2004).

With the market in unquoted company shares very illiquid and few transactions reported, price and false expectations arise as a result of different valuation assumptions and models used by different advisers. This produces a wide variation between buying and selling prices which reduce the prospect of sales. While more active markets would result in closer alignment in pricing and more sales, both buyers and sellers can often be cautious about revealing they are seeking a transaction, causing the market to continue to be far from transparent. Sellers will be wary that if suppliers, customers (and staff) became aware of a likely change of ownership, this would affect future contracts and actions to the detriment of the operation. Meanwhile, buyers will be concerned that, informed of the identity of the potential buyer, the seller will modify the price or terms of any deal (Netherlands Ministry of Economic Affairs, 2003).

Finding a successor is further hampered by asymmetric information – the owner knows more than any potential buyer about the true worth of the company, including such intangibles as customer goodwill, industrial relations, etc. (Netherlands Ministry of Economic Affairs, 2003). In addition, in order to evade tax, some owners may understate the true value of their business (Goodchild, Sanderson and Leung-Wai, 2003) – offering them short-term income gains, but diminishing the chances of finding

a buyer. Such issues are less likely to arise in the case of transfers occurring within the family (or even firm), where knowledge of the firm and its capabilities allow transparency on both sides and a truer assessment of its business prospects. In general, however, the information problem is especially significant in relation to smaller businesses, because of the typically poorer accounting information and the difficulty in assessing the importance to the firm of the owner him/herself (Netherlands Ministry of Economic Affairs, 2003).

It should also be recognised that time constraints – the bugbear of small businessmen everywhere – affect business transfers. For some, time can be devoted to selling or buying a firm (and thus gaining information about the market), particularly for someone who is currently an employee, and who may not wish the employer to know about his/her entrepreneurial ambitions (Netherlands Ministry of Economic Affairs, 2003). These constraints restrict the extent of knowledge of the market for firms among smaller buyers and sellers – this is a market that most entrepreneurs facing business transfer (or seeking to become an entrepreneur) only seek to engage with once or twice in a lifetime.

In addition – and importantly in terms of the supply-demand balance – it may be that the demand for businesses is lower than may have been thought. Amongst UK entrepreneurs who exit their firms, under 15% are found to buy an already *existing* business. There was a much stronger chance that they would continue their old business in some form, or even seek paid employment, instead (Stokes and Blackburn, 2001). In the Netherlands, of those considering become an entrepreneur, 61% reported they would rather start their own business rather than acquire an existing one (Netherlands Ministry of Economic Affairs, 2003). Furthermore, many businesses seeking to transfer ownership are in declining industries, while entrepreneurs would often rather found a business in a younger, more dynamic sector (Voithofer, 2002).

Finally, the impediment to the operation of the market of incumbent owners' idiosyncratic management style must be recognised. The issue has been flagged up at a number of points in this review of available research. The problem for the would-be purchaser is to assess whether he/she wants to (and is capable of) interpreting the management system of the incumbent owner to permit the firm to operate at the required performance level. The issue is starkly (if

colloquially) illustrated in the comment: 'A lot of times, what entrepreneurs do is they create a job only they can do... So when they are looking for a successor, the only person who can do the job is them' (*National Underwriter*, 23.2.04). When taken in conjunction with the high proportion of one-person or micro businesses that make up the population of firms facing transfer, this is an important business transfer consideration.

The current literature alerts us to theoretical problems with the market for firms which are likely to impair its functioning. It offers specific examples of problems that occur and the way in which smaller businesses are affected. However, there is a research gap in that there is no systematic study of the UK market identifying the extent to which market deficiencies contribute to business transfer problems, and the practical ways in which they might be alleviated. In particular, as a recent study of the informal venture capital market in Scotland shows, in relation to small firms, these markets are effectively highly localised (Paul *et al.*, 2003). Additionally, the characteristics of those markets – including the articulation with the wider market for firms – are only poorly understood at present

A4.2.4 Taxation aspects

The UK tax regime has been modified in recent years in ways that assist the transfer process. The year 1998 saw the introduction of capital gains tax (CGT) taper relief, the rules of which are designed to encourage investment in small and medium-sized trading enterprises. Under this scheme, assets that are used for an unincorporated trading business and shares in unlisted trading companies qualify for the generous business asset taper relief rate. A number of relaxations of the taper relief rules have been made since 1998. Among the changes included in the Finance Acts of 2000 and 2001, the government introduced a four-year taper that reduces the effective rate of capital gains tax on business assets from 40% to 10% (HM Treasury, 2001a and 2001b). From 2002, the chargeable gain on an asset that qualifies for business asset taper relief, and that has been held for at least two years, is charged to CGT at an effective rate of 10% for a higher rate taxpayer.

Findings from empirical research confirm the widespread impression that the current capital tax regime in the UK is perceived to be more favourable than previous regimes and than most current European examples. Capital taxation is not thought to

influence strategic or operational decisions either positively or negatively, although unexpected changes in policy and procedures can impose additional burdens on both owners and consultants. 'The present capital taxation regime which includes gift relief and business asset taper relief within capital gains tax, and 100% business property relief within inheritance tax eases succession planning', conclude Casson *et al.* (2003). In addition, the business asset taper relief is also said to aid exit strategies for shareholders.

Anecdotal evidence from entrepreneurs (see later sections of the Evidence and Key Stakeholder Opinion), suggest the new capital gains tax regime is very popular and that tax is no longer a deciding factor in investment and exit strategies. Research into the investment activities of business angels in Scotland, even concludes that EIS scheme tax relief has no effect upon business angel investment (which includes involvement in transfers), with the main determinant being a lack of suitable investment opportunities (Paul *et al.*, 2003). While, in a recent report from Grant Thornton (2002), costs associated with the red tape surrounding tax compliance are given more prominence as a hindrance to effective transfer than are tax issues. For some investigators, issues like family relationships are considered more crucial to successful transition. Extensive survey-based work in the USA lead Morris *et al.* (1997) to conclude that, 'family business owners [should be] encouraged', 'to devote relatively more attention to relationship issues and relatively less to estate and tax planning', while for Sharma *et al.*, (2001) 'family satisfaction with the handover process' is more important to successful transfer than either tax or policy regimes.

The tax regime also accommodates a concern raised in a Small Business Council paper (SBC, 2003b) focusing on Recourse Owner Funding as a means of funding transfers. The approach entails the purchasing entrepreneur paying a deposit and effectively borrowing the balance of the purchase price from the existing owner (vendor). The paper identifies the problem of capital gains legislation giving rise to a tax liability for the vendor on the date of sale, even though the cash has not been received. In fact, provisions currently exist for tax liability to be due when payments are made in an instalment type arrangement, providing certain criteria are met.

The current UK tax system applies to transfers of small businesses as follows:

Retiring owner. Where the business is a company, the shares can be gifted to the next generation. Because the parties are connected, capital gains tax would be chargeable as if the shares had been sold at their market value. If the company was a trading company and the shares had been held for at least two years, then the tax rate on the gain would be 10% for a higher rate tax-payer.

Alternatively, the owner could claim gifts relief and pay no capital gains tax. Instead, the new owner's base cost of the shares would be reduced, resulting in an increased chargeable gain when he/she eventually sells/passes on the shares. But again, a very low rate of capital gains tax is likely to be chargeable on the eventual disposal.

The same principles apply to disposals of unincorporated businesses except the charge attaches to the business assets themselves as there are no shares.

Deceased owner. Capital gains tax is not chargeable on death. Inheritance tax is charged on the value of the estate as at the date of death. But business property relief (or agricultural property relief) is likely to apply, reducing the inheritance tax payable on the assets or shares of a family business in most cases to nil. The purpose of these reliefs is to enable family businesses, which are generally illiquid and might otherwise need to be sold off to pay an inheritance tax bill, to continue to operate.

The only area of the tax system identified in the (financial press) literature as a significant obstacle to succession is the change introduced in Schedule 22 of the Finance Act 2003. The reform, introduced in mid-2003, was designed to ensure that employees awarded shares and securities as part of their remuneration packages were liable to income tax and national insurance on value received. The change has, however, impacted negatively on certain types of business transfer activity – especially university spin-outs. Academics granted an equity stake in such a spin-out, under the new system, found that they could be faced with a tax bill to be paid up-front, rather than when equity stakes are cashed, as per the capital gains tax model. Not only does this measure give rise to a disincentive effect on enterprise, but it also deprives the academic-innovator of money that

might be invested in the company. The Chancellor of the Exchequer has recently announced his intention to bring forward legislation to remove this constraint on spin-out activities.

A4.2.5 Finance

As with taxation, financial constraints in the UK appear generally to impose relatively light burdens on the successor, despite the majority of transfers requiring at least some capital sourced from outside the firm. Family continuity of ownership is not generally threatened by cost or access to external financing. Indeed the facility to gift shares and business assets (where transactions often involve no cash) is the most popular approach to the transfer of family business ownership. This is followed by inheritance arrangements (Grant Thornton, 2002). A bank loan was found by the Grant Thornton survey to be 'important' in over 40% of UK family transfers, although both business profits and family equity capital were ranked more highly. Meanwhile, about 20% of such transfers were totally market-based. In spite of the fact that the survey excluded small firms (minimum sales turnover for inclusion was £1 million), none of the firms indicated venture capital or business angel funding as the most likely source of capital for funding future transfers – a reflection, according to the authors, of their 'inward-looking financial planning'.

There is overseas evidence, from both Germany and the Netherlands, that the cost of funding a transfer is a more serious difficulty (Netherlands Ministry of Economic Affairs, 2003; Institut für Mittelstandsforschung, 2002). Indeed in Germany, around half of external transfers run into financing problems. However, this is likely to be related to ongoing economic difficulties in both those countries, and there is relatively little sign that credit constraints cause problems for transfer per se in the UK, as opposed to the normal day-to-day operation of the business. There are anecdotal concerns that DTI's Small Firms Loan Guarantee does not enable businesses purchases as banks are reluctant to offer loans even if three quarters of the sum (up to £250k) would be guaranteed by Government. However, the literature appears to offer no evidence on this issue.

We have been able to uncover no systematic research into the issue of finance and business transfer, beyond the Grant Thornton survey (2002) which itself relates only to larger SMEs and medium-sized firms, and accounting studies of specific

methods of financing transfer (which seem to abound in the USA). Questions that need to be addressed include:

- the relative ease with which small firms can access finance for transfer compared to start-up (given that most lending is cash flow-based);
- whether purchase cost or cost servicing constitutes a barrier to ownership transfer;
- whether financial institutions consider that risk is lower in relation to an existing as opposed to completely new business;
- the effect of size of firm, and its location and sector, upon the availability and terms of finance;
- the impact upon access to capital of the original owner staying on within the business after the transfer; and
- the extent of awareness of financing sources and succession possibilities on the part of employees, who, Mandl (2004) shows, are frequently the successors.

The absence of reliable information relating to such questions constitutes a research gap that hampers the analysis of any need for support measures.

One of the issues raised above is whether financial impediments to transfer exist within particular locations. A recent report on finance for small firms (Bank of England, 2002) suggests that this might be the case in deprived areas – which are identified above (section A3.4) as locations where the business transfer issue is potentially of greater significance. The following observations are made in the report:

- Only around half of self-employed people have a separate business bank account.
- Firms are subject to noticeably higher margins on loans and they borrow less compared to other areas of the country.
- More businesses in deprived areas than elsewhere are in sectors not usually covered by the Small Firms Loan Guarantee.

- Incomes of the self-employed are lower than for the self-employed elsewhere (as are savings and property values (collateral)).

- The credit-scoring element used in banks lending decision processes produces more high-risk customers in deprived areas than elsewhere.

The report concludes that businesses in such areas are likely to experience a negative impact upon their ability to access bank finance. This raises the possibility of a heightened chance of business transfer failure in areas where negative effects, both in relation to the individual businesses and the local economy, are likely to be more pronounced than in more prosperous parts of the country.

A5. Firm types experiencing business transfer failure

This section draws upon the literature relating to the factors behind business transfer failure. It outlines the various processes at work in relation to business transfer and seeks to highlight the more complex patterns existing between business type and obstacles to transition.

On the whole, the research into business transfer concentrates on the managerial arena, rather than sectors or the size of the firm per se, with much of the literature focusing on studies of family-owned businesses. Family firms are identified as the main general area of concern, with particular sub-groups (i.e. defined by size, sector etc.) more at risk of transfer failure. This will help in identifying target groups for policy purposes, but there are still some gaps in our knowledge of the firm types most likely to experience business transfer failure.

It should be noted that the literature search did not reveal any empirical work that suggests business transfer is a special problem for either ethnic minority businesses or female owner-managers. Indeed, what data there is – from the Centre for Women's Leadership, Babson College, USA – indicates that women are more likely than their male counterparts to have chosen a successor (49% to 40%).

A5.1 GENERIC AND BUSINESS TYPE CLASSIFICATIONS

Martin *et al.* (2001), in their wide-ranging report for the Small Business Service, identify five basic factors that put firms at risk of transfer failure:⁴

- the business is intended to meet the owner's personal, 'lifestyle' goals, rather than being focused on strategic business objectives;
- poor business performance;
- the business relies on the owner's specific knowledge (of markets, customers, systems, etc.) – knowledge that cannot be easily passed on to a successor;

⁴ Business advisers responding to a recent survey (with a sample of 441), reported that managerial dependence on the owner (3rd bullet point), closely followed by lack of preparation for transfer (fifth bullet point) were the main barriers to straightforward transfer, accounting between them for around 60% of the responses. Business Adviser Barometer, 9/2004 (See Section B, Part I)

- lack of a suitable and willing successor manager drawn from the ranks of employees or the owner's family; and

- the absence of any (medium-term) plans for transfer

On the basis of the current review, this typology can be confirmed as offering a fairly robust framework of analysis. To throw more light upon the types of businesses likely to be at greater risk of transfer failure, these factors need to be considered, alongside a series of other key influences over transfer (also identified by Martin *et al.*). Given that business transfer is most often achieved via sale to an outside (non-family) party, the attractiveness of a business to buyers, especially outside buyers, is an important determinant of business transfer outcome. Firms identified as vulnerable to business transfer failure will face fundamentally different transfer situations according to their type of firm:

- Occupation-based, worker-owner, micro-businesses, like plumbers or hairdressers in rented premises, will normally be dependent on finding a new owner with the appropriate occupational skills.
- Businesses with significant assets like vehicles, owned property or retail outlets, can be attractive to potential purchasers on the basis of these assets alone.
- Medium-sized, knowledge-based, niche businesses are likely to be of interest to entrepreneurs and larger businesses seeking to expand or move into the market area by acquisition. Such businesses often have specialised facilities or product/service ranges, a quality customer base and a strategic approach.
- 'Hybrid' businesses, which mix knowledge-based and physical assets, can be less straightforward for transfer as a going concern, particularly where they are weakened by the owner's lifestyle objectives or idiosyncratic management style.

A5.2 SIZE OF FIRM

There is strong evidence that small firms are more at risk of business transfer failure than their larger counterparts. Research in Germany revealed that successful transitions were concentrated in firms with over 20 employees, and that micro-firms and sole traders were under-represented among the transitions (Institut für Mittelstandsforschung, 2002).

The Austrian Institute for Small Business Research found a higher proportion of business failures among sole traders compared with those firms with employees (Voithofer, 2002; Mandl, 2004). It is clear from the review of literature that some of the key factors associated with business transfer failure tend to be more frequently associated with smaller owner-managed businesses, compared with larger firms and businesses where there is an explicit separation of ownership and management. Smaller firms are not only found to be less likely to engage in business transfer planning – an important cause of business transfer failure (see section A4.2.1) – but also find themselves at a particular disadvantage when seeking to sell the business on the open market (section A4.2.3).

Wang *et al.* (2004) provide further evidence that business transfer planning is linked to size. Among UK family-owned businesses, business transfer planning is more likely to be used in medium-sized than small family businesses. Figures were given above (section A4.2.1) that show the greater reluctance of small firms to draw up a business transfer plan. This difference relates to the fact that larger businesses tend to have a more formalised and hierarchical structure, leading to a greater likelihood that planning procedures are in place to cover most eventualities. Larger companies also typically have a higher level of staff development, creating a pool of potential successors with suitable skills to draw on when the owner decides to exit the business. The smaller companies in Wang *et al.*'s survey lacked the requisite management skills and business strategy to pursue such avenues. Furthermore, relatively few small firms employ non-executive directors, a basic strategy to formalise a firm's organisation (Westhead, 1999), since many owners are reluctant to cede a measure of control, particularly over checks and monitoring, to 'outsiders' (Fiegener *et al.*, 2000). Stavrou (2003) puts this down to the 'extraverted' psychological nature of owner-managers – their focus is not on the firm, but rather upon something external to the firm (i.e. their family). This means that their planning processes are not purely intended to meet business objectives, which leave them open to strategic difficulties.

Small firms are also in greater danger of business transfer failure because the market for firms tends to work less effectively in relation to them – as was discussed in section A4.2.3. At a time when the market sale route to transferring property is

increasing in importance (a rising number of firms reaching business transfer, falling proportions of inter-generation family transfers, etc.), the literature indicates that the system does not operate evenly among SMEs. Harvey (2004) describes the practical problems confronting small firms seeking to transfer *via* a trade sale. Problems with a trade sale for small firms arise because of the typically restricted size of the vendor's network. This limits the number of potential buyers at any point in time, reducing the possible price that the business can attract. The firm thus may need to employ an intermediary, with all the problems of assessing the quality of the solicitor or accountant who might undertake this task. It is also possible, of course, that the networks of the intermediary are similarly small, and thus his/her ability to identify a potential buyer (or give informed advice on valuation) is likely to be limited. Management buy-outs/ins tend to be concentrated towards the top of the small firms market (i.e. firm values in the millions rather than hundreds of thousands of pounds).

A5.3 SECTORS AT RISK

There is relatively little analysis of sector-specific concerns around business transfer – the majority of the research tends to assume, implicitly or explicitly, that cross-sectoral issues are of lesser importance than, for example, strategy or family relationships. The only investigation focusing specifically upon sectoral aspects of transfer is that of Goodchild *et al.* (2003), who examine four sectors in New Zealand associated with self-employment or small owner-managed firms: agriculture, retail, engineering and accountancy

They find different patterns of business transfer in each of the four sectors, linked to the industry's particular structure and characteristics. The sector that they identify as most at risk of business transfer failure, and with the most varied patterns of business transfer, is *retail*, where around 45% of exits are through closure. Small retailers, they assert, tend to prioritise short-term cashflow over long-term business transfer planning, with the difficulties being exacerbated by poor employee retention (limiting the choice of a natural successor), and the personal/branded nature of customer relationships. In engineering, the more pressing problem is the lack of young people entering the industry with the potential to develop the management skills to take over an existing business when the owner retires. Although the authors take the view that these characteristics

are specific to retailing and engineering, they would also seem to have some applicability to other businesses. This is clearly a research gap and further research on this more structural approach to understanding business transfer would be likely to yield valuable insights.

In relation to Austrian firms, Voithofer (2002) and Mandl (2004) use the AISBR business transfer model (see section A2.3) to identify the sectors with an above-average proportion of firms facing imminent transfer. They find that these tend to be firms in 'traditional' sectors, that had faced restructuring and contraction, with relatively low levels of attractiveness to buyers (e.g. due to low profitability). In many cases, the owner was simply keeping the business going until they could either sell the business satisfactorily, or reach retirement. The sectors included:

- craft-based businesses (especially in areas of construction, bakeries, butchers, and hairdressers);
- clothing manufacturing;
- trading firms in textiles, clothing and paper products;
- transportation firms; and
- travel agencies/tourism.

Dynamic, expanding industries, such as businesses in the fields of information and consulting which, in addition to perceived profitability, are found to have ownership age profiles that are lower than in most other sectors (Voithofer, 2002; CPA Australia, 2004). Butler *et al.* (2001) come to similar conclusions in their study of nearly 300 American firms, suggesting that attractiveness of a firm to a purchaser is conditioned by views associated with the sector, rather than objective measures of the performance of the specific firm. Also, the pool of employees in some firms tends to be too small, and/or lacking the requisite skills to complete an internal transfer. Successful transfer thus requires a greater degree of planning and preparation, and possibly employee development, in some sectors more than others.

Analysis of successful transitions in Germany's Baden-Werttemberg showed that older firms (i.e. those formed in the 1960-80 period) were prominent as were businesses in the trade and hotel/catering sectors.

Skilled service providers (mainly established in the 1990s) were identified as under-represented among the successful transitions (Institut für Mittelstandsforschung, 2002). Finally, it is interesting to note from this data that lack of profitability does not appear to have been a major factor in preventing transfer – 40% of the firms that underwent a transfer were not making a profit prior to the change. This is possibly an indication of low profitability generally, and expectations of improved trading conditions in Germany. However, it may also imply – as suggested above – that judgements relating to the purchase of a firm are based upon factors other than just operational performance – such as the more general prospects for sector it occupies. This is consistent with the earlier observation (in section A3.3) that closures/exits are relatively evenly spaced in time, rather than bunched in recession years.

A6. Support for the transfer process

This section describes the principal means by which the potential for business failure is being addressed, both in the UK and overseas. It does not include much by way of critical analysis of effects of interventions, since little evaluation of such projects appears to have been undertaken thus far, presenting us with yet another knowledge gap. Importantly, the section sets the various interventions in a consistent framework, based upon the different identified causes of transfer failure (market failure etc.).

A6.1 EXISTING FORMS OF SUPPORT

Much of the business transfer literature is concerned with the *internal dynamics* of family businesses, including topics such as the interest of children inheriting the business, the role of the mother of the heir, and the separation of family and business. Many of these internal issues are entirely family matters, related to trust and affability (Morris *et al.* 1997) and the solutions to these problems are to be determined by the incumbents. There are, however, forms of support that provide an assisted solution to business transfer for incumbents (Burke, 2003). The issue of family disputes can be resolved through a *family constitution*, most likely successors identified through a *skills audit* and managerial successors prepared for their role through *mentoring*. Through this assisted *internal* intervention business incumbents become more able to foster appropriate successor values and develop new leaders from within the business.

This section, however, primarily considers *external* assistance from third parties. Many of these services can be delivered either by public agencies or private sector companies, the latter (particularly banks, accountants and close professional confidants of business) providing these services in an integrated manner, along with other related services such as estate planning.

In 1994, the European Union devised a list of 21 tax and legal measures for business transfer, but by 2002 only approximately half of these measures had been introduced. Response to the issue of business transfer has been slow at national level, although the UK is among the more compliant of member states in implementing the 1994 suggestions. At a more local level there are numerous initiatives supporting business transfer (e.g. that by Advantage West

Midlands, see section A6.3) and by 2002 EU experts had identified no fewer than 53 support measures for business transfers which have been included in the support measures for enterprises database (SMIE)⁵

A6.1.1 Awareness raising and information

One of the principal problems with business transfer is that planning occurs too late and only at crisis points which bring the issue to the fore. It has been shown above that over 60% of UK businesses have no business transfer plan, and there is a tendency for owner-managers to defer formulating such a plan in favour of carrying out day-to-day running of the business.

A crucial requirement is thus to raise awareness of the issue for the present incumbent. In fact, for effective transfer to take place (whether within the family/firm or to outsider), it is important also to inform the potential successor(s) about the process, because of the need for a training/familiarisation/handover process to occur.

The following case studies of key types of intervention under the heading of information provision are drawn from those that are regarded (without any special justification) as 'exemplars' within the European Commission (2003). The initiatives deliver support that effectively alerts owner-managers and potential successors to the range of issues associated with the transfer process. These initiatives, it should be emphasised, constitute a joined-up attempt 'to develop more process-orientated support (coaching) stretching over the whole transfer of business process rather than individual actions focusing only on one aspect' (Enterprise Directorate General, 2003).

One-stop shops for business transfers are offices that hold information and expertise on all aspects of business transfer in one place, and allow access to a range of specialist technical knowledge. *Example:* The Chamber of Commerce and Industry (*Industrie- und Handelskammer, IHK*) of Erfurt (Germany) has established a one-stop shop for potential buyers and sellers; lawyers, tax advisers, representatives of banks are all available to provide advice within one setting [www.erfurt.ihk.de].

Mentoring can provide knowledge-based support in different business transfer situations. *Example:* *Chris Martin and Associates* (UK) have developed a mentoring process to recognise the business's core

⁵ See www.europa.eu.int/comm/enterprise/smie.

competencies and intellectual capital. It challenges the entrepreneur to understand the strength of the business and where the exit options lie [www.chrismartinassoc.co.uk]

Online information portals can provide an alternative to the above mechanisms, by organising and presenting information on a website. This service may be extended to include a marketplace function (see 'market failure', below).

Managerial support offered to successors can include counselling, diagnostic and aptitude testing. *Example: Rabobank Succession Programme (NL)* – to reduce the failure rate after succession, Rabobank launched a programme for intensive support and counselling of both the outgoing and incoming entrepreneur. Part of the programme is an assessment of the successor's managerial and entrepreneurial skills, undertaken by GITP, an independent professional HRM institute [www.rzo.nl]. This kind of initiative addresses two of the three key factors behind succession failure (identified by analysis of a large database by Mandl (2004) in Austria), namely the failure by the successor to make use of an external consultant, and the successor's lack of experience.

A6.1.2 Assisting business transfer planning

The third main factor in business transfer failure (both in terms of achieving a transfer and post-business transfer performance) identified by Mandl is the failure of owner-managers to consider the business transfer process through means such as a written business transfer plan. A range of initiatives has been developed in various countries to provide professional guidance to businesses that engage in business transfer planning.

A self-analysis check-up allows a business to diagnose its relative strengths using self-assessment tools. *Example: Kit-brunello (Italy)* – written in five languages, directs 100 critical questions at owner-managers approaching business transfer, to help them identify the strong and weak points of the business. Technical aspects (financial and legal), are included, as well as identification of emotional and psychological factors. [www.kit.brunello.net]

Inter-generational transfer assistance focuses specifically upon meeting the stated preferences of families for an inter-generational transfer. *Example: Passing the baton* – The Finnish Employment and

Economic Development Centres have developed a service to help specify the status and expectations of both the entrepreneur relinquishing the business and the successor. It considers suitable candidates for business transfer, determines the financial value of the enterprise, clarifies tax and legal matters and assesses the financial options of alternative methods of transfer. Participants develop a written plan. [www.te-kesku.fi]

Transferring to co-operative status can be an option in some transfers – an idea supported by some initiatives. *Example: The French Confederation Generale des scop* consists of five stages: detection of transfer opportunities; validation of membership of the parties participating; validation of the feasibility of the project; finalisation of the project; and implementation. The confederation also provides finance for the cooperatives in the form of capital, operating funds and bank guarantees and organises training courses for directors and co-operative members [www.resoscope.org] If the finding the AISBR researchers – that 70% of successors in Austria are employees in the business prior to transfer – hold for the UK, then this suggests that buy-out options are likely to be an important source of demand for firms being sold outside the family.

A6.1.3 Market failure – matching buyers and sellers

Market failure occurs when information about the sale of a business is not communicated effectively to the market, resulting in potential buyers being unaware of businesses for sale. It seems logical that if a marketplace for business transfers clearly signalled the availability of businesses then fewer business transfer failures would occur. It is possible for an external agency (private or public) to act as a broker to bring together sellers and potential buyers and help affect a transaction.

Whilst the public announcement of a business for sale attracts buyers, Van Rijk (2003) highlights the problems that can crop up when a sale is publicly advertised – suppliers not renewing contracts, customers looking for alternative suppliers and staff leaving for fear of their future employment. Sellers may therefore be reluctant to communicate the sale of a business. Buyers also face a problem of an inflated sale price if sellers learn that their business fits the profile of a strategic buyer. These considerations provide further support for using an intermediary to discreetly facilitate a transfer. Such an approach allows a firm to avoid business disruption costs.

Websites potentially are an effective way of facilitating market activity, and a number of portals have been established to achieve improved matching. Van Rijk has reviewed online portals offering such a brokerage service. On the basis of this work, he proposes that, for effectiveness, an 'acquisition platform' of this kind should incorporate four characteristics:

- It should provide a nationwide database with information on the market, sellers, buyers and consultants;
- With the information obtained from the database, the platform should actively search for suitable candidate buyers and sellers;
- Entrepreneurs should be able to contact the platform with all questions, after which they can be referred to consultants in their own region and within their own sector; and
- There should be a nominal registration fee and a charge for successful completion of a business transfer.

Many **banks offer support owners in finding buyers** for their businesses. This sometimes involves a bank running their own databank, generally in co-operation with SME organisations. *Example: Change/Chance* (Germany) – Mittelstandsbank, the Federation of Chambers of Commerce (DIHH), the German Confederation of Skilled and Small Businesses (ZDH), in collaboration with the national government, the German savings banks and the co-operative banks have launched an integrated programme on business transfer. The first part consists of three databases accessible through the internet: one with companies for sale (currently 8,000 registered), one with a nation-wide calendar of events on business transfer and one with addresses of consultants active in this field. [www.change-online.de]

The EC Best Project (2001) emphasises linking separate public and private databases at a national level to have a unified database to increase the likelihood of matching buyers with sellers. The first steps have been taken towards a Europe-wide database (under the domain name *match-online*), with national members and following a common format. The Danish site is already online (to date, the only one) and satisfies all of van Rijk's criteria, as well as preserving the anonymity of sellers and therefore

avoiding business disruption costs. *Example: Match online* – in addition to matching buyers and sellers, enterprises can also seek equity finance and investors may offer equity capital. All the companies are described anonymously, but with reference to the intermediary making the registration. The criteria for searching prospective buyers and sellers are by industrial classification, employees, turnover, value of the business and geographical location. [www.match-online.dk]

A6.1.4 Financial failure

If successors (whether within families or from without) are unable to raise sufficient finance then business transfer failure may occur. Even though external finance may be available, owner-managers are often reluctant to relinquish control to venture capitalists and would rather face the risks of an undercapitalised business than to seek an external equity investor (Grant Thornton *et al.*, 2002).

Recognising that the nature of financial impediments to business transfer varies according to the business involved, a range of **tailor-made financial supports** for business transfers has been developed, including take-over loans for the successor. *Example: Contrat de developpement transmission* (France) – in co-operation with the client's house bank, the French public funding institution BDPME offers medium-term loans (maximum eight years) to business successors without any collateral and a grace period of three years. BDPME can participate up to a maximum of 40% of the loan. [www.bdpme.fr]

In some circumstances, **temporary intervention** in the form of capital is needed to maintain the financial position of the businesses at the stage of business transfer. Adequate solvency can be achieved through temporary participation in a firm's capital base, using support in the form of specific Reinforcement Funds. Along the same lines, banks can act to mediate with venture capital funds or business angels in raising additional equity. *Example: Alliance Entreprendre* (France) – an investment company set up by the French savings banks and Caisse des Depots Group, takes a minority share in bigger SMEs, especially in companies at the transfer stage. Investments range from 0.3m to 2.3m Euros for a period of four to six years. [email: alliance-entreprendre@wanadoo.fr]

A6.1.5 Enabling and educating the support system

Support systems relating to business transfer are only partially developed. Such systems (both private sector and public sector) ideally need nationwide coverage of services delivered to a recognised standard. The challenge of increasing the number of trained professionals requires that there be more training and education for those within the system responsible for interacting with clients. Typically, management training is biased towards large companies, rather than to smaller firms – where the business transfer issue is more prominent. The format and curricula of management training should therefore specifically accommodate SMEs and the business transfer issue.

Policy action includes training of customer-facing personnel, such as account managers and personal business advisers, in issues related to business transfer is needed if the support infrastructure is to be effective. Further, keeping track of changes in the environment of SMEs (legal, financial, economic, etc.) is essential in order to provide adequate support.

Example: Qualification Programme for Account Managers (Germany) – the German savings banks have implemented a comprehensive qualification programme for account managers on business transfer. The various banks' training centres, such as that in Württemberg, offer relevant courses, while all account managers have also been issued with an instruction manual (for internal use only) on business transfer support.

A6.1.6 Tax policies

While the impact of the taxation regime upon business transfer decisions in the UK is regarded as broadly neutral, this cannot be claimed for regimes in some EU countries, in spite of progress towards that goal. Thus, taxation impacts differently upon business transfer according to the country under review. Tax initiatives as they affect this issue can be instructive, although being set in a specific wider context do not necessarily have relevance for other countries. Thus, the Czech Republic, recognising benefits of transfer of ownership to family members, has structured inheritance and gift tax in order to discriminate in favour of family firms, adopting a rate of 1-5% for direct relatives, 3-12% for other relatives and 7-40% for other persons.

A6.2 EU BUSINESS TRANSFER SUPPORT SYSTEM

In spite of coordinated efforts over a decade to address issues relating to business transfer, the system still has its weaknesses, as acknowledged at a 2002 seminar in Vienna.⁶ The main ones are as follows:

- The Enterprise Directorate General of the EU itself recognises 'that a lot of support is available for business transfers but not in a structured manner and thus not necessarily reaching the right target audience' (2002). In particular, the mix of private and public sector support is seen as lacking in *coordination*.
- Reviewing the profile of available support, it can be observed that coverage across the different categories of intervention is uneven between member states, and indeed within them.
- While the business transfer failure issue highlights the fact that there are too few buyers in the marketplace and that it is important to encourage more potential buyers to enter, the majority of support measures ignore the *demand* for businesses.
- Most of the policies are concerned with mediating the change or transition, rather than whether the *performance after transfer* will be successful.

A6.3 SUPPORT SYSTEM IN ENGLAND

Business Link Operators (BLOs), soon to fall under the management of Regional Development Agencies, are the main public sector agency responsible for addressing the business transfer issue. The matter was recently taken up by the RDA Advantage West Midlands, which has established a project aimed at improving advice and help for small firms facing business transfer. Analysis supplied by 43 Business Link Operators in England during 2003-04 (*Succeeding in Family Business*) shows that two-fifths of the local offices are actively seeking to determine support needs in relation to business transfer in their area. Around a quarter include within their delivery plan the objective of identifying for their area the 'at risk' companies. Action plans for intervention include awareness raising, focused training for businesses, and access to specialist advice on legal, financial and other professional areas. For each of these areas, more than one-third of the Business Link Operators state they are developing active provision, referring businesses to specialist advisors where appropriate. BLOs are thus ascribed a

⁶ European seminar on the transfer of businesses, 23-24th September, 2002, Vienna

key part within a network of potential support that includes a small number of large firms, with a reputation in this field (Grant Thornton, Stoy Hayward and Baker Tilly), supplemented by numerous other professionals scattered throughout the country. Accountants are more frequently approached than other sources by firms facing transfer and in need of advice; other sources of assistance consulted include banks, company brokers, business transfer agents, solicitors and inheritance tax planners (Stokes and Blackburn, 2001).

To develop their capacity for delivery in the business transfer field, BLOs are focusing especially upon training their front-line staff in the various aspects of transfer support. It is noticeable that just one BLO identifies businesses owned by ethnic minorities or women as requiring special support. This would appear entirely consistent with the indications of need from the current literature (see introduction to section A5). The BLO delivery plans are also interesting in that access to finance is not highlighted as a particular support priority.

The research literature, as has been shown, alerts us to factors that are important if the market is to work properly, and to some of the specific problems which arise in relation to small firms that need to make use of it to achieve a transfer. In the previous section, some key issues around EU systems of support for business transfer were identified. Those issues would appear to be relevant in the context of this country's system. Indeed, numerous questions arise with respect to the operation of the system supporting business transfer in this country, including:

- the capacity of the system to provide business transfer support – that is, wherever possible, integrated as central aspect within business development and thus part of long-term business planning covering technology, training, product development and other issues in the post-business transfer period;
- the competence and independence of accountants, brokers and others involved in the process. Can they deliver effective advice and support, including accurate assessments of a firm's value? Do they possess (1) the developmental skills or knowledge needed to address long-term planning requirements of business transfer, and (2) the 'softer' relationship areas of coaching, mentoring, management and conflict resolution?;

- the means by which owners approaching business transfer can assess the likely quality of service offered by intermediaries;

- the role for Business Link Operators in terms of direct and indirect support. Are BLOs in a position to identify 'at risk' businesses in their area?;

- the attitudes of advisers and agents towards employee buy-outs, and their knowledge of schemes for achieving such transfers;

- the potential role of trade associations – organisations which often have detailed information on businesses for sale and potential buyers and can facilitate access to a contacts network both locally and beyond; and

- the means by which effective demand for firms facing transfer can be increased.

The literature does not provide us with ready answers to these (and other) questions, although they are important in terms of policy-making on business transfer.

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A

Part two:
Business transfer
Annotated bibliography

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DURHAM UNIVERSITY BUSINESS SCHOOL

Annotated bibliography

This section provides an annotated bibliography of key sources considered by the Durham University Business School team. It is broken down into sub-sections depending upon whether the source was a research report, journal article or 'other'.

A7. Reports

Barclays plc (2001) *Third Age Entrepreneurs – Profiting from Experience*, Barclays

This report concentrates on the needs of over-50 entrepreneurs, but mostly describes the characteristics of their businesses, with little about specific succession needs. It notes that the average retirement age of such entrepreneurs is, unsurprisingly, likely to be higher than for younger entrepreneurs, with a substantial minority 'having no idea' when they will quit. The number of such entrepreneurs is likely to increase in the coming years.

Blackburn R & Stokes D (2002), *Who are the Entrepreneurs? A Survey of Owners of SMEs*, Kingston Smith/Small Business Research Centre, Kingston University

Based on a survey of 360 SMEs, the authors find that owners identify themselves as either 'modern' or 'traditional' entrepreneurs, although the authors find that the actual differences between the groups are smaller than that division might imply. They find cause for cautious optimism: three-quarters of respondents were in profit, and half had experienced growth, although there was some feeling that government legislation and regulations were checking this growth, to an extent. However, although the majority wanted to expand their business in the future, two-thirds of businesses had no exit plan. Higher growth was likely to come from younger business with owners who consider themselves to be innovative, while the more profitable firms tended to be smaller and more mature, and run by older managers.

CPA Australia (2003) *Small Business Policy: Where to from Here?*, Discussion Paper, CPA Australia

A general discussion on small business policy in Australia, from the perspective of financial advisors. The brief section on succession planning notes that 30% of small business owners in the country are over 50, and this proportion is steadily increasing, implying that there will be increasing numbers of businesses coming to market, since entrepreneurialism among heirs seems to be limited. Equally, the report notes,

services firms tend not to be developed to support 'family dynasties' in the same way as manufacturing firms were. The report also indicates that many businesses must be prepared to be 'fit for exit', via restructuring, succession or business transfer planning etc. On the macro level, it recommends that government policy needs to look at the impact of potential closures on deprived areas, and that transition can be used to stimulate innovation or sectoral restructuring (e.g. consolidation of SMEs). It concludes by recommending the development of an Office of Small Business Advocate, specifically to lobby government and conduct research on relevant issues, and provide an intermediary between firms and government.

CPA Australia (2004) *Small Business Succession and Exits*, CPA Australia

Probably the most recent major survey included in this bibliography, the Australian association of financial advisors interviewed 600 small businesses and 105 advisors on business transfer issues in March 2004. With 30% of owners now over 50, the association considers that the scale of potential problems is set to increase substantially. Currently, 7.5% of small firms exit annually, and 40% of owners plan to exit in the next five years, but a third of these anticipate that finding a buyer will be difficult, due to the need for the manager to have specific skills, personality or lifestyles. However, *overall*, three-quarters of owners thought it would not be difficult for someone else to run their business. The association recommends an awareness-raising strategy about planning for exit, especially since many intend to use business proceeds to retire on – if owners have no obvious successor, or regard the firm as too small, they tend to fail to have any exit plan. Advisors estimate the actual incidence of planning as substantially lower than that reported by owners, casting some doubt on the accuracy of both this survey and others in this bibliography. There is reluctance to spend time or resources on planning or restructuring, as opposed to just speculatively advertising the business as up for sale. In macro terms, the business stock is growing, and the contribution of business churn to innovation is recognised. Nonetheless, it is noted that a pool of viable, efficient *continuing* businesses is needed for economic stability and growth. Only 14% of exiting owners anticipate starting another business; over half plan retirement.

Dunemann M & Barrett R (2004) *Family Business and Succession Planning: A Review of the Literature*, Family and Small Business Research Unit, Monash University, Australia

The authors undertake a comprehensive review of the succession planning literature, encompassing family culture, management and financial issues, planning, life cycle and the external environment, as well as a particular focus on models of business transfer planning. They conclude that, although external influences (e.g. institutional and governance models) play a part, it is 'human' influences that are of most concern, and that the entire process of business transfer planning should be filtered through the analysis of family relationships, individual attitudes and experiences, cultures and values. Therefore, the likelihood of finding a single model applicable to all circumstances is slim. However, the authors identify some common factors, which form a sort of checklist for success: the identification, preparation and management of a successor in good time; the acknowledgement of individual roles and needs within the process (including ownership and inheritance); a coherent family vision and business plan; and good, open communication channels.

Goodchild M, Sanderson K & Leung-Wai J (2003) *Self-employment and Small Business Succession in New Zealand*, Report for Future of Work Fund, prepared by Business and Economic Research Ltd, New Zealand

One of the few reports to look specifically at self-employed succession, rather than family firms *per se* (although this sector also includes owner-managers with employees, by the authors' definition). It concentrates on sectors where self-employment is high in New Zealand: agriculture, retail, engineering and accountancy, each of which exhibits different patterns and problems of transfer. Within agriculture, transfer remains dominated by inheritance, although there are also some novel employee buy-in schemes, and transfer tends to be relatively smooth. Retail, by contrast, has a much higher closure rate, but this tends to be financially unsatisfactory. The sector has problems relating to long-term planning (in opposition to the priorities of short-term cashflow), and employee retention, while business performance and personal branding further inhibit successful transition. Many engineering companies may sell to larger firms (especially overseas investors), and employee partnerships/buy-ins are quite common, although there are some difficulties with recruiting younger employees to take over. Accountants, on the other hand, tend to be highly mobile between firms, taking clients with them – making them effectively self-employed. On retiring, clients tend to be referred to other firms, meaning there is no real firm 'succession' as such, although planning is still key to accomplishing a successful referral.

Grant Thornton, SandAire, Manchester Business School (2002) *The Financial Affairs of UK Family Companies*, London

Based on a 2002 survey of British firms, with good representation of SMEs and family-owned businesses, the authors examine the willingness and ability of the next generation to take over family firms, particularly in terms of the financing of successions. The funding of transfers to heirs, they find, is governed by a strong adherence to a pecking order, with internal profits being preferred to external short-term debt, and external equity capital a last resort, due to issues surrounding dilution and loss of control. Most family companies pursue a relatively informal approach to business transfer planning, with few adopting a family constitution. Barriers to family continuation are found to be lack of enthusiasm, the mismatch of priorities relating to business, on the one hand and lifestyle, on the other, and the growth of the company beyond the family's management skills.

Institut für Mittelstandsforschung [Small Business Research Institute] (2002) *Generationenwechsel in Baden-Württemberg [Generational Change in Baden-Württemberg]*, Report for L-Bank, State Bank for Baden-Württemberg (DTI Translation 04-0341b/German/KS/MC)

Based on survey of 320 small businesses in Baden-Württemberg, the report is a comprehensive look at all aspects of the transfer process. They find that around 15% of all business transfers take place unexpectedly, and that only 40% of company owners have planned for this eventuality. Transfers increasingly take place outside the family (mainly because offspring are not interested in the business), despite outside business transfer tending to run considerably less smoothly. The major obstacles are finding the 'right' successor, and lack of experience – inter-family successors have often worked within the firm for some time. Capital is required in three-quarters of takeovers, and in half of these, the capital requirement is unplanned. Around half of successors also have problems with financing. Most advice on transfers comes from tax accountants, and a substantial minority do not seek support elsewhere. Finally, many companies up for transfer are unprofitable, implying that the key support measure is to aid the restructuring of such companies, within a coherent business transfer plan.

Martin C (2001) *SME Ownership and Management Change: A Business Continuity and Development Perspective*, Knowledge Management Centre, University of Central England

Based on a project funded by Birmingham Council to work with 20 SMEs on plans for ownership and/or management succession, the author finds a complex picture of exit routes, unique to each business. As well as succession within individual firms, the report touches on the importance of succession to economic development issues, and how succession support can be integrated with regeneration schemes. The factors that influenced succession in the cases studied fell into three areas: (a) owner motivation, which varied with age, health and circumstance; owners were reluctant to confront their own mortality; (b) managerial capability – owners who had worked in other organisations seemed better able to cope with business transfer planning; and (c) business prospects – most businesses needed some performance improvement to improve the chances of sale. The structure of both the business (from small 'artisan' firms to more hierarchical larger organisations) and ownership (single/multiple/family) also influenced the exit and business transfer strategies. The support approach adopted had four stages: clarification of position, identification of options, developing (a number of) business transfer plans, and developing an action plan.

Martin C, Martin L & Mabbett A (2002) *SME Ownership Succession – Business Support and Policy Implications*, SBS

The authors conducted a comprehensive literature survey and collaborative research with business support agencies from three English regions, as well as interviews with accountants and company brokers. They conclude that business transfer becomes a critical concern as owner-managers reach their late 50s, necessitating planning to be addressed by owners by their early 50s. Thus, age-related business transfer failure is identified as the area of most concern, with around a third of owners falling into the vulnerable cohort (according to national statistics). Narrowing this group down, the authors find that firms with 10-50 employees, without a distinct management team, were highly vulnerable – some 54,000 businesses, nationally. Other factors which increase vulnerability include: businesses having lifestyle, not strategic, goals; poor performance; over-reliance on the owner's managerial contributions; the lack of a natural family or employee successor; the lack of a business transfer plan. Support should focus

on awareness-raising and aid to make businesses fit for exit (restructuring, training etc.), and should take account of local needs (e.g. in deprived areas). The report is also available as a Research Summary (RS011/02).

Netherlands Ministry of Economic Affairs (2003) *Transfer of Business*, MEA

A report on the business transfer situation in the Netherlands, which raises a number of relevant issues. There are around 20,000 transfers annually, of which 76% are still in business five years later, with an average of five jobs retained per transfer (*versus* two created by start-ups). First, it is noted that policy should not impose a burden on the entrepreneur – government must avoid the pitfall of 'overloading' the transfer process with unnecessary organisational change. The report also discusses the two routes of (a) wholesale government *intervention* (more active – financing, bearing the cost of risk) against (b) *facilitation* of transfer (a more hands-off approach, ensuring the smooth operation of market). The justification for the latter position is the existence of market failure. There is asymmetric information in the transfer of business, mainly Akerlof's 'lemons' problem – how to tell a good business from a bad one while lacking detailed internal knowledge. An agency problem also exists (the training of new owners by old). The smaller the transfer, the greater these problems are. These failures may limit the financing available for and the overall extent of the business transfer market. Internal (family) transfer reduces the information problem. Proposed solutions include the government to supply matching funds to aid the marketplace; the establishment of a national network/database etc.; and support aimed correctly at businesses.

Rutherford R (2002) *Topic Note on Family Business*, SBS Analytical Unit

A brief summary of the relevant research, the author notes that the SBS *Household Survey* confirms that intergenerational succession is a relatively minor means of transfer, echoing other findings that only 14% of UK family businesses survive to the third generation. He points out that there is insufficient evidence to judge if family businesses require specific support, as there are no conclusions as to whether such firms face an advantage in the market, or endemic market failure. An assertion that family businesses require different support because they are different is insufficient; support could most usefully targeted where there is a high risk of succession

failure, i.e. where the available market mechanisms for transfer (and/or supporting or advising on transfer) are failing family firms.

Small Business Council (2003) *Succession: another way to transfer the ownership of existing businesses*, SBC, London

The report focuses specifically on ways of encouraging entrepreneurs to take over businesses rather than establish one from scratch. The author concentrates on one particular method: 'recourse owner funding', where the purchaser pays a deposit, and 'borrows' the remainder from the vendor. The deal resembles the sale of options to buy shares in the business in future. Both buyer and seller face benefits and risks. The buyer has high initial outgoings and low capitalisation, while poor performance may allow the vendor to retake control. Against this, buying an established business may be less risky, the purchaser gains a mentor (the vendor) and the necessary initial capital is low, benefiting those who may not be able to get conventional credit. The seller has to defer full payment for his assets, but could achieve a quicker sale and their staff (and self-esteem) is supported by business continuity. At the macro level, the benefits consist of business and employment continuity, and possible boosts for productivity and efficiency (through business reorientation by new owners), with the attendant risks of low capitalisation and low investment by new owners. The report goes on to outline the legal and tax framework needed to encourage such schemes.

Stokes D & Blackburn R (2001) *Opening up Business Closures: A Study of Businesses that Close and Owners' Exit Routes*, Report for HSBC, Small Business Research Centre, Kingston University

The authors attempt to plug a gap in the literature by focusing on what happens to both owner and firm during and after the exit process, drawing on 20 interviews with business advisors and a survey of 388 exiting managers of UK SMEs, 20 of whom were interviewed in greater depth. They discover a broader spectrum of closure than simple 'business failure' – their typology consists of: financial failure (18%); not meeting owner's objectives (31%); 'technical' closures, where the business is reopened in a different form (17%); and selling the business on (34%). Only the first of these is a true business failure. Among exiting owners, they find that the majority (60%) wished to continue running a business, while 10% retired and 30% departed

entrepreneurialism (to become employees, inactive or unemployed), and that all had acquired new skills from their experience, even if they had lost financially. Since there seems to be a 'revolving door', rather than a 'one-way exit', the authors suggest more resources should be targeted on experienced 'exiting' entrepreneurs to help them continue in business, while business transfer can be viewed more broadly than simply the continuation of an existing business.

Stoy Hayward Consulting/London Business School (1989) *Staying the Course: Survival Characteristics of the Family-owned Business*, London

Looking at 15 family firms in the UK, the authors showed that business management was influenced by differences in family elements across the firms. This was most obvious in the overlapping of commercial and family goals; the effectiveness of human resource management both relating to family members within the firm and to outside employees; and the way businesses dealt with ownership and business transfer issues.

Voithofer P (2002) *Business Transfers and Successions in Austria*, Austrian Institute for Small Business Research, Vienna

An update and refinement of earlier study, the author uses a survey of small businesses to report on a number of factors influencing transition, with an abundance of information but little overarching structure or argument. Around a quarter of Austrian businesses are expected to face a transfer in 2001-10, more than 60% of which have fewer than five employees. The sectors with the highest proportion facing business transfer are 'traditional', and relatively unattractive to buyers (e.g. construction, clothing manufacture, bakeries, trade in textiles and paper). Around 18% of transfers failed outright, although this may be attribute to structural change, and may not be negative, in a macro sense. Virtually all 'successful' transfers were still in business five years later, although around 14% faced some difficulties. Overall, therefore, the total success rate for transfer is roughly two-thirds. The proportion of family transfers is steadily declining. Only a small proportion of owners had a specific transfer plan, although virtually all used outside consultants, particularly tax advisors. Policy recommendations centre on raising awareness and improving the transparency and functionality of the transfer market.

A8. Journal Articles

Aldrich H, Zimmer C & McEvoy D (1989)
'Continuities in the study of ecological succession: Asian businesses in three English cities', *Social Forces* 67:4, 920-44

The authors' thesis is that that 'ecological succession' leads to ethnic changes in business ownership, as firms reflect the residential environment around them. Using a multi-wave panel study for 570 small retail establishments in British cities from 1978-84, they find that, as urban areas evolve, white businesspeople tend to cease buying shops in areas where the Ethnic Minority Business (EMB) population is expanding, and that EMB owner-managers tend to transfer firms within their own ethnic group. This could either limit the size of the potential market for EMB shop transfer, or, given the strong networks within EMB communities, could lead to a greater chance of successful market transfer. More research may be needed to determine which is the stronger influence.

Bachkaniwala D, Wright M & Ram M (2001)
'Succession in South Asian Family Businesses in the UK', *International Small Business Journal* 19:4, 15-27

The authors examine succession in UK South Asian family businesses, through a case study approach using a very small sample (five firms), which raises issues as much as seeks explanations. In particular, the article looks at immigrant Asian business creation as a way to circumvent blocked upward mobility; the ambitions owner-managers have for their heirs (e.g. integration, greater external opportunities); the enthusiasm of the heirs for 'traditional' employment in the family business; and the effects of discrimination. The notion of intergenerational transfer as a preferred route does not emerge as particularly clear-cut, and the authors recommend more research on the motivations of owner-managers in this area.

Bailey EE & Helfat CE (2003) 'External management succession, human capital and firm performance: an integrative analysis', *Managerial and Decision Economics* 24, 347-69

An article that concentrates on external succession, specifically the transferability of the human capital possessed by the successor. Using an analytical approach based on matched pairs of firms, the authors examine the relationship between post-succession firm performance and the skill-set of the

successor, finding, initially, that very few companies hire a successor from a completely unrelated sector. They also find that there is no difference in *mean* firm performance whether the successor comes from within the same industry or from a related industry, but that, among the latter group, the *variance* of post-transfer performance is greater. This, the authors hypothesize, is due to 'outsiders' making more aggressive changes with less certain outcomes, and boards being better informed about within-industry successors' skills, and thus more able to make an informed choice. For a smoother transition with a related-industry successor, boards need to be able to find as much information as possible to match the successor's skills to their company.

Barach JA & Gantisky JB (1995), 'Successful succession in family business', *Family Business Review*, 8:2, 131-55

The authors attempt to model a framework incorporating the factors that influence the succession process, concentrating in particular on those that can be controlled by the major actors. External environmental factors are also incorporated, with the recognition that these forces can only be partially *dealt with*, rather than effectively *managed*. They identify twelve critical factors in the succession process, covering management practices, firm organization and performance, and family relationships and apply them to a medium-sized Canadian retail outlet. They find that the most important factors relate to the family – one consultant notes that he will not help a family business unless he finds 'love... and personal faith' [for the business and each other], and conclude by noting that the happiness of successors is more important than being forced into the family business. Their policy recommendations revolve around counselling for the family, diversifying heirs' business experience, using outside mentors and restructuring the business.

Birley S (2001) 'Owner-manager attitudes to family and business issues: a 16 country study', *Entrepreneurship Theory and Practice*, 26:2, 63-76

Birley bases her characterisation of owner-managers on a large, international (16-country) study, but her conclusions are mainly of tangential reference to the issue of succession. She points out the difficulties in generalising across countries, due to the very different outlooks of owner-managers, and emphasises that owner-manager attitude is the best way to understand the family business sector than either equity or management control.

Bjuggren P-O & Sund L-G (2001) 'A transaction cost rationale for transition of the firm within the family', *Small Business Economics* 19, 123-33

The authors attempt to plug a gap in the literature, by explaining why inter-family business transitions are the preferred form of succession for family-owned firms. A mostly theoretical approach settles on knowledge specificity (or 'idiosyncrasy') as the main deciding factor, arguing that close family relationships over an extended period facilitate transfer of knowledge and minimize asymmetric informational problems, more effectively than training a successor from outside the family. This minimizes the cost, and therefore maximizes the efficiency, of the transition, leading the authors to advocate policy to increase the proportion of intergenerational successions accomplished within the lifespan of the entrepreneur.

Butler JE, Phan PH, Saxberg BO & Lee SH (2001) 'Entrepreneurial succession, firm growth and performance', *Journal of Enterprising Culture* 9:4, 407-36

A quantitative study of a succession outcome decision model, based on data from 294 Chinese firms in the USA. The authors emphasise the complexity and uniqueness of each transition, and find that differences in ethnicity *within* similar ethnic groups (e.g. between Hong Kong and Thai retailers) impact on succession issues, as do education, social status, and the political system. Family succession depended on family members making a positive impact on performance, although prior performance in general has little impact in the succession decision. However, expectations of *future* poor performance reduced the likelihood of family succession. The authors suggest more research is needed to discover why this is: sparing a family member the trouble of running poor firm, or the reluctance of a family member to take over? Finally, the attractiveness of firms to potential buyers may well be based on a wider view of the sector, not solely on objective measures of the individual firm.

Cabrera-Suarez K, De Saa-Perez P & Garcia-Almeida D (2001) 'The succession process from a resource and knowledge-based view of the family firm', *Family Business Review*, 14:1, 37-47

A major challenge facing the family firm is the succession process. One reason for this challenge might involve the successor's ability to acquire the predecessor's key knowledge and skills adequately to maintain and improve the organisational performance of the firm. This paper uses two theoretical

approaches from the strategic management field to explore this critical process and analyse how it can be managed effectively: the resource-based theory of the firm and the emergent knowledge-based view. This conceptual framework provides a powerful tool for understanding the nature and transfer of knowledge within the family business, which becomes the basis for developing competitive advantage over non-family businesses.

Callejón M & Segarra A (1999) 'Business dynamics and efficiency in industries and regions: the case of Spain', *Small Business Economics* 13:4, 253-72

According to the conventional view, business turbulence has a positive impact on manufacturing in terms of innovation and allocation of resources, although empirical studies are inconclusive. The authors note that many existing studies tend to concentrate on 'cutting edge' industries, rather than those more representative of middle-range economies, like Spain, where new firms are users of innovations, rather than innovators themselves. In their model, new entrants embody available edge technologies, while exiting firms are obsolete. They model the effects entry and exit have on productivity growth, using data from the Spanish Industrial Registry. They find that the degree of churn is related to the structure of sectors, and that where barriers to entry are high, so are barriers to exit. The exit rate is negatively correlated with the business cycle phase, although not as closely as the link with entry rates. Survival rates are relatively stable across time (and different countries), and small firms have particularly low survival rates.

Casson P, Jennings PL & Allen C (2003) 'The impact of capital taxation upon UK unquoted companies', *Environment and Planning C: Government and Policy*, 21:4, 509-30

The authors interviewed senior executives of multigenerational family businesses on their perceptions of the impact of capital taxation on unquoted companies. Interviewees used professional advisors, had non-family board members, and promoted managers (and, by implication, successors) through merit rather than nepotism. Although the current tax regime is more favourable than in the past (as well as in comparison with other countries), and directors are aware of and maximise taxation allowances related to succession issues, the regime still has some impact on succession. Ownership seen as separate from management, but this becomes blurred in practice, especially in regards to succession.

They noted that the individual ownership stake of family members was diluted with each passing generation, but a 'moral obligation' towards family members remained. Finally, continuity and consistency in tax policy was given high priority, due to the costs of keeping up to date with changing regimes.

Chrisman JJ, Chua JH & Sharma P (1998), 'Important attributes of successors in family businesses: an exploratory study', *Family Business Review*, 11:1, 19-34

Based on a Canadian survey of 485 family firms, the authors examine what firms themselves consider the most important attributes of a successor, compared to those routinely reported by the literature. The literature survey yielded 30 variables, encompassing the successor's personal relationship with the incumbent/family, competence, personality and involvement with business. While initial results confirmed that the majority of these variables had significance, vindicating the current research, the two most important were 'integrity' and 'commitment to the business', followed by the respect of employees, business competence and interpersonal skills. 'Entrepreneurial' attributes (aggressiveness, willingness to take risks, independence) were ranked relatively poorly, as was outside experience, suggesting families prefer successors who will not make radical changes. Among modifying influences, length of service was highly important: the longer a successor has been involved with the business, the more 'welcoming' the family were to him, and more open to his appointment as successor. The larger the firm, the more the family wanted strategic, rather than operational, attributes. Where there is a relatively large number of non-family managers, successors need greater strategic and interpersonal skills, to deal with potential conflicts. Gender and birth order of heirs appear to be relatively unimportant: the successor no longer needs to be the first-born male.

Cliffe S (1998) 'Facing up to succession', *Harvard Business Review* 76:3,16

A brief summary of recent research from Arthur Andersen/Mass-Mutual on family business, based on a survey of 3,000 family companies with sales of more than \$1m. The research found that, mainly due to demographics, the CEOs of around half of these companies were due to retire in the next ten years, but two-thirds of firms have no written strategic plan, boards are weak and rarely meet, and 42% of companies had plans for family members to serve as co-CEOs, which is 'notoriously difficult and fragile.'

Reasons behind this state of affairs include the desire of the founder to treat heirs equally, thereby avoiding hard decisions over appointing one as successor and the emotional attachment of the founder to their business. The average length of time served by family CEOs (six times that of public company CEOs) leads to any change being a complete upheaval, creating an even greater need for planning. However, family wealth was more diversified than expected, which could aid CEO retirement, while financial sophistication, in general, is increasing.

Cross L (2002) 'Successful succession', *Graphic Arts Monthly* 74:8, 26-29

US case studies of privately-owned printing firms, which demonstrate the choices available and the different aspects of succession (business capability, the financial situation etc.). The author emphasises the importance of long-term planning and avoiding family complications, and looks at cases involving selling to a third party vs. passing on to a family member, including the need to develop new management models in the process. She points out that only 13% of family businesses reach the third generation, ascribing this to the fact that many owners see the issue of succession planning as purely being about capital or inheritance taxes.

Davis PS & Harveston PD (1998) 'The influence of the family on the family business succession process: a multi-generational perspective', *Entrepreneurship Theory and Practice* 22:3, 31-53

An American study, which tested a variety of hypotheses related to succession, using data collected during 1993-94 from around 1,600 family businesses with at least ten employees and alive for over ten years. The authors find that, among the characteristics of the owner-manager, only their age is a good predictor of whether or not they have established a succession plan in *younger* firms; furthermore, even the importance of this variable diminishes substantially in multi-generational businesses. Family members outside the day-to-day management team exert little influence on succession planning.

Dunn B (1996), 'Family enterprises in the UK: A special sector?', *Family Business Review*, 9:2, 139-55

The author sets out to examine whether the claims in academic literature that family businesses are a special case are true, and what implications this may have for policy, which currently treats all firms of a

similar size as having similar development needs. Using data from a series of Scottish workshops, and interviews with ten Scottish firms, the author found that, due to their responsibilities to the family, most managers thought that long-term goals, emphasising incremental growth, were more important to family firms than non-family, and that the firm (or a job therein) was seen as a birthright. However, all were aware of the dangers of this philosophy, as succession planning either had been previously mismanaged (e.g. two co-CEOs, leading to power struggles) or was currently being ignored. Family firms were seen as being more embedded in their community, including the adoption of a more active social role, in addition to being important local employers. The authors conclude that family firms require at least some differentiated support, distinct from non-family firms, and that more research is required to say exactly what that support needs to focus on.

Fiegener MK, Brown BM, Dreux DR IV, Dennis WJ Jr (2000) 'CEO stakes and board composition in small, private firms' *Entrepreneurship Theory and Practice* 24:4, 5-24

Based on a US survey of 2,300 small private firms, the authors only briefly touch on issues of succession. They find that in firms where the CEO is planning to appoint a family member as their successor, they tend to expand their board to include a greater proportion of family members (as opposed to external directors), including the chosen successor, as part of a broader process of training their successor in management practices. The authors hypothesize that this tactic is an attempt to internalise, or 'absorb' the complex family business issues, by cutting down on the number of 'outsiders' involved.

Fox M, Nilakant V & Hamilton R (1996), 'Managing succession in family-owned businesses', *International Small Business Journal*, 15:1, 15-25

Based on a literature survey, the authors focus on the relationship between the incumbent, their successor and the business itself within family firms, in order to develop a six-point planning format, which outlines the corresponding tasks that family businesses must undertake to encourage effective succession. These six tasks map onto six different categories of relationship, which must be nurtured and assessed: (a) the business itself and its key stakeholders; (b) the incumbent and the business itself, preparing for a new role; (c) the successor and the business itself, finding an effective heir; (d) the successor and the

incumbent, managing the delicate handover process; (e) the successor and key stakeholders, so that the handover does not unduly impact on other interested parties; and (f) the incumbent and key stakeholders, establishing the credibility of the successor as leader. Although there is no practical assessment of this approach, it provides a way to understand the particular relationships that are at work within family businesses, and a roadmap of where, and what type of intervention may be necessary.

Gibb AA (2000) 'SME Policy, academic research and the growth of ignorance, mythical concepts, myths, assumptions, rituals and confusions', *International Small Business Journal* 18:3, 13-35

The author looks at the widely-believed 'myths' that academic research has thrown up, especially the development of policy without the active involvement of SME owners. It provides a background critique of flaws in the conduct of SME policy processes and academic research thereof.

Goldberg SD (1996) 'Research note: Effective successors in family-owned business', *Family Business Review*, 9:2, 185-97

Based on a survey of 63 US family business CEOs, the authors attempted to discover differences between 'more effective' and 'less effective' successors (measured by increases in profit and revenues). They find that the most statistically significant differences between the two groups stem from (a) external influences: the more favourable CEOs' opinions of short- and long-term sectoral prospects, the more effective they were; (b) personal characteristics, notably the CEO's relationship with their father, and whether they were happy as a child – the authors extend this to suggest that any good mentoring relationship would benefit successors; and (c) the CEO's involvement with the business: 'more effective' successors became more involved with the business at an earlier age (5-7 years younger than 'less effective' successors). The type/organisation of the business appears to have little impact, although effective successors maintained a network of advisors, and tended to make important, 'revitalising' changes. Policy recommendations include the use of mentoring, ensuring the chosen successor is involved with the business as early as possible, and possibly restructuring the business to make it more attractive and/or viable.

Hadjimanolis A & Dickson K (2000) 'Innovation strategies of SMEs in Cyprus, a small developing country', *International Small Business Journal*, 18:4, 62-79

A comparative analysis of 25 case studies of Cypriot manufacturing SMEs, with particular reference to management style and innovation. The authors construct a simple typology of firms, distinguishing them as 'proactive innovators', 'reactive innovators' or 'non-innovators'.

Headd B (2003) 'Redefining business success: distinguishing between closure and failure', *Small Business Economics* 21, 51-61

The author uses data from the 1996 US Census Bureau's Characteristics of Business Owners survey, relating to relatively recent start-ups (1989-92), to tackle the assumption that business *closure* is the same as business *failure*. He finds that the *successful* closure rate is high: only one-third of new businesses closed under circumstances that the owners regarded as unsuccessful. The sector with the highest proportion of unsuccessful closure, and with low survival rates overall, was retail trade, suggesting policy and research needs to focus on this sector.

Hirschfeld C (2002) 'ESOPs as an estate planning vehicle for business owners', *Journal of Financial Planning*, 15:11, 92-97

The author examines Employee Stock Ownership Plans, schemes which are designed to invest primarily in the stock of the sponsoring employer. As well as benefits to the employee, an ESOP allows an employer to diversify holdings and create liquidity, while (if only a minority of shares are distributed) retaining control in the hands of the original shareholder. In succession terms, an ESOP allows heirs to redeem shares from an estate on a tax-deductible basis, while the diversification permitted by ESOPs facilitates the designation of non-business assets to certain heirs, allowing those interested in the company to continue managing it.

Janjuha-Jivraj S & Woods A (2002) 'Successional Issues within Asian Family Firms: learning from the Kenyan experience', *International Small Business Journal* 20:1, 77-94

The authors, drawing on a survey of well-established Kenyan Asian family businesses in Britain, argue that ethnicity has a significant impact on succession, and that the lessons are applicable to other EM groups experiencing firm transition for the first time. They argue that EM firms are established by immigrants to

create a 'secure base', in a new, uncertain situation, tying succession up with emotional bonds in an informal business structure that further confuses the boundary between business and founder. EM owners, the authors note, are more reluctant to leave the business, and prefer internal, informal succession processes (via 'good conversation'), with mothers of heirs as crucial generational buffers.

Kelly P & Hay M (2003) 'Business angel contracts: the influence of context', *Venture Capital* 5:4, 287-312

Based on a survey of 106 UK business angels, the authors empirically test an agency theory model of the effect that the attributes of the contracting partners and the deal itself can have on the contract between business angels and entrepreneurs. Business angels, they argue, are important as the largest source of external funds for entrepreneurs outside family and friends, but contracts face problems of opportunist behaviour – adverse selection (agents may misrepresent their abilities to gain funds), moral hazard (agents expend less effort than required as they are unobserved) and high risk activity (as agents only bear a fraction of the costs of their actions). The authors find that business angels are more actively involved in a partnership with their firms than agency theory might suggest, and contracts tend to be a framework for developing roles and responsibilities. There is, however, a great deal of importance attached to contractual safeguards, and the more an angel invests, the greater the level of detail in the contract.

Kets de Vries MFR (1993) 'The dynamics of family controlled firms: The good news and the bad news', *Organizational Dynamics*, 21:3, 59-71

Based on interviews with 300 executives in family firms, the author looks at why the lifespan of such firms tends to be so short – 24 years on average, with only 30% of firms making the transition to the second generation, and only 10% to the third. He finds that, although family firms have certain advantages (independence, family pride, flexibility, specific knowledge), there is also confused and autocratic management, nepotism, family strife and financial strain. The main barriers to effective succession planning are couched in individualistic, personal terms: fear of founder's death (on the part of both the founder and the family); the founder's emotional attachment, difficulty in choosing between heirs and envy of losing power to the next generation; family rivalry; and the founder's spouse's desire to cling to

a position of privilege. Against this can be weighed facilitating forces: tax legislation, the founder's wish to leave a legacy, shared management (or splitting the business) etc. Ultimately, the author recommends an effective family council, including some 'outsiders', coupled with strategic planning and an open corporate culture.

Kirby DA & Lee TJ (1996) 'Research Note: Succession management in family firms in the North East', *Family Business Review* 9:1,75-85

The authors gauge the opinions of 35 North East family firms, mostly of second or later generations, on the succession process, particularly their reactions to the emphasis usually placed on the need for planning. They find evidence of cynicism regarding the effectiveness of such plans, and that few plan the succession process beyond five years (as opposed to the recommended twenty years they claim to find in the literature). However, they recognise that informal procedures exist in many of the firms under examination, and that entrepreneurs may be intuitive thinkers, rather than planners, with at least some idea of their successor formulated at an early stage. The policy recommendations include not imposing overly formal procedures on family-run SMEs, but rather instituting general HR development, while recommending a more long-term, longitudinal approach to future succession research.

Le Breton-Miller I, Miller D & Steier L (2004) 'Towards an integrative model of effective FOB succession', *Entrepreneurship Theory and Practice* 28:4, 305-28

The authors attempt to draw together the fragmented literature on top executive succession within family businesses, in order to synthesize a more comprehensive model of successful transitions, as well as to identify areas of broad consensus and trends, and any gaps in the current research. They find that the most commonly used predictors of success have been incumbent and successor attributes (and the relationship between the two), followed by preparation of the successor, ground rules for succession planning, phased transitions and composition of boards. Their synthesized model emphasises the chronological process aspects, from ground rules, through nurturing, to actual transition, with attributes of management, family and boards as contextual variables. Gaps include more detailed investigation of the actual processes (e.g. how do you make the 'ground rules'? What are they?), appraisal of successors through time (pre- and post-transition),

feedback loops (i.e. the processes are not as linear as they are often characterised), and the broader family, sector and social context, all of which need to be incorporated into future models.

Miller D, Steier L and Le Breton-Miller I (2003) 'Lost in time: intergenerational succession, change and failure in family business', *Journal of Business Venturing* 18:4, 513-31

The authors address the situation where a family's desired successor – in this article, restricted to cases where this is the son of the firm's founder – is not the 'best' person for the job, and the problem becomes how to cope with a less than optimal transfer after the fact, rather than how to achieve an optimal transfer in the first place. They find that such a transition tends to lead to one of three attitudes in the successor, all related to the firm's past: 'conservative' (too attached), 'rebellious' (prone to making aggressive changes) and 'wavering' (blending elements of past and present incongruously). They suggest that further research is needed to discover how each of these could be used as a focal point for change to make the post-transition business more efficient.

Morris MH, Williams RO, Allen JA & Avila RA (1997) 'Correlates of success in family business transitions', *Journal of Business Venturing* 12, 385-401

Based on extensive interviews with second- and third-generation family business owners, the authors construct a quantitative model of family business transition, and test it with data from 209 firms. The model consists of three basic determinants: the preparation level of heirs, family relationships and management activity. They find that transitions are smoother when heirs are better-prepared, transition is more planned, and (most importantly), when family relationships are 'trust-based and affable'. Performance post-transition, however, is harder to forecast.

Morris MH, Williams RW & Nel D (1996) 'Factors influencing family business succession', *International Journal of Entrepreneurial Behaviour & Research*, 2:3, 68-81

The article is very similar to Morris *et al.* (1997), identifying the same three factors as important for successful transition: preparation of heirs; family relationships and planning; and control activities. The latter covers slightly different ground, by explicitly stating that a lack of *formal* planning does

not mean a complete absence of planning; they point out that 'plans' are often open, fluid and unstructured, and are aimed at not undercutting the family relationships that are at the heart of successful transition. On the other hand, a greater level of succession planning (either formal or informal) *is* associated with smoother transition.

Paul S, Whittam G & Johnston JB (2003) 'The operation of the informal venture capital market in Scotland', *Venture Capital* 5:4, 313-35

The authors examine the informal Scottish investment market, based on a survey of 140 active business angels. They find that, in particular, the majority lack experience in dealing with small businesses, and aim to address the ways by which entrepreneurs can target angels, and how angels find and invest in small firms. In policy terms, they find that the existing tax relief scheme is not critical in encouraging individuals to become angels, nor in their investment decisions. Also, angels report a lack of suitable opportunities for investment, citing a shortfall of 'investable' entrepreneurs. This implies that steps could be taken to make entrepreneurs more investment-ready.

Potts T, Schoen JE, Loeb ME, Hulme FS (2001) 'Effective retirement for family business owner-managers: perspectives of financial planners, part 1', *Journal of Financial Planning* 14:6, 102-15

An article which assembles a literature review relating to the factors for effective retirement as a prelude to the construction of a questionnaire (further analysed in the second part of the article). The authors recognise that retirement planning for owner-managers is not just about an investment strategy (as many owners, advisors and financial planners view it) but rather intertwined with leadership succession, business continuity etc. There is also recognition of the degree of ambivalence about retirement that is common to many owner-managers.

Poutziouris PZ (2001) 'The views of family companies on venture capital: empirical evidence from the UK small to medium-size enterprising economy', *Family Business Review* 14:3, 277- 91

An explorative research paper based on a survey of 240 UK SMEs, looking at the family business demand for venture capital. The author uses the pecking order theory – private companies, including family-controlled ventures, have a propensity to finance their operations in a hierarchical fashion, first using internally available funds, followed by debt and, finally, external equity. The statistical analysis confirms that family companies

adhere strongly to this principle of financial development. The paper explores factors governing the rationale of owner-managing directors for considering venture capital dealings as well as their main areas of concern. To encourage equity development of smaller privately held companies, particularly family firms, there is room for policy initiatives that respect the financial philosophy of private companies.

Roberts MJ & Tybout JR (1997) 'Producer turnover and productivity growth in developing countries', *The World Bank Research Observer* 12:1, 1-18

Using detailed data from Chile, Colombia and Morocco, the authors examine the reallocation of resources within and across sectors due to entry, exit, expansion and contraction. They find that around a quarter of total manufacturing jobs turn over every year, although the immediate productivity impact is negligible, due to new plants being small and only slightly more productive than their predecessors. In the longer term, those plants that survive the first few years register substantial productivity gains, while those exiting had rapidly declining productivity, leading to large overall increases. Thus, artificial means to prevent failing businesses from exiting can be counterproductive, reducing both productivity, and potentially employment (if firms downsize rather than close outright), particularly over longer periods.

Salvanes KG & Tveteras R (2004) 'Plant exit, vintage capital and the business cycle', *The Journal of Industrial Economics* 52:2, 255-276

Using a panel of Norwegian manufacturing plants, the authors attempt to distinguish between two competing hypotheses: the learning model, where exit rates decrease with plant age and the vintage capital theory, where exit rates increase with the age of capital. They find that both effects apply, to an extent, and that exit rates depend on the business cycle, increasing in severe downturns.

Sharma P, Chrisman JJ, Pablo AL, Chua JH (2001) 'Determinants of Initial Satisfaction with the Succession Process in Family Firms: A Conceptual Model', *Entrepreneurship Theory and Practice*, 25:3,17-35

The authors draw on theories relating to organisation, behaviour, economics and, in particular, stakeholder theory, to attempt to integrate findings from the diverse literature on family business leadership succession. They develop a model of factors

influencing initial satisfaction with the process, which should feed into the overall effectiveness of the succession. Their conceptual model builds on the three necessary components: the leader, and their propensity to step aside; the successor's propensity to take over; and the mechanism of handover (succession planning). Also included are variables relating to family members' willingness to continue the business and their acceptance of their roles in the process. This covers the main stakeholders, how their stakes may be affected, the power they have in the process, and the urgency they may bring to it. Further empirical research is needed to test this model.

Shepherd DA & Zacharakis A (2000) 'Structuring family business succession: an analysis of the future leader's decision making',

Entrepreneurship: Theory & Practice, **24:4**, 25-40

Using behavioural economics theory as a starting point, the authors suggest that the greater the financial and behavioural sunk costs of a successor, and the more they feel they have the 'right' to lead the firm, the more successful a transition is likely to be. The successor will value the firm more highly, and is less likely to undertake risky activities. Their sample to test the hypothesis consisted of 59 potential family business leaders undertaking business education at American universities – a group which is more likely to conform to the rational hypothesis of the article. The results suggest that succession should be structured so that the successor has to 'buy in' to the company, in terms of their own capital and time, and to earn their right to lead. The successor is less likely to sell the company if this is accomplished, but the time spent earning their place may encourage more risky business decisions, at variance with the authors' original hypothesis.

Stavrou ET (2003) 'Leadership succession in owner-managed firms through the lens of extraversion', *International Small Business Journal*, **21:3** 331-47

A largely theoretical article, examining the decision-making processes of owner-managers of small firms through their psychological outlook, in an attempt to construct an over-arching theory of the dynamics of succession. The author proposes that the motives of small business owners are 'extraverted' – i.e. they are not solely focussed on their business, and the business exists to satisfy some 'external' objective, rather than having a coherent strategy for growth. In most cases, this is a 'lifestyle' objective, to meet the needs of the family. This objective is a hindrance to a

smooth transfer process, it is largely antithetical to making decisions from a business perspective.

Wang Y, Watkins D, Harris N & Spicer K (2004) 'The relationship between succession issues and business performance: evidence from UK family SMEs', *International Journal of Entrepreneurial Behaviour & Research* **20:1/2**, 59-84

Based on empirical analysis of 169 family-owned SMEs, the authors find that the most significant difference between family-owned and non-FO businesses is how executive succession occurs. The development of a successor contributes positively to business performance, and the authors advocate both a training charter and the use of specialist external consultants and training courses to bolster management teams' effectiveness. Their research confirms Morris *et al.*'s (1997) thesis that harmonious family relationships facilitate succession, particularly in smaller firms, which tend to lack both a formalised, hierarchical structure, and a formal succession plan.

Westhead P (1999) 'Factors associated with the employment of non-executive directors by unquoted companies', *Journal of Management & Governance* **3:1**, 81-111

Using a sample of over 400 UK firms, the author employs a regression model to determine the relationship between size of firm and appointment of non-executive directors (NEDs). He finds that older and larger companies were more likely to employ a NED, regardless of most other variables. Micro firms, and in particular owner-managed micro firms, were the least likely to employ a NED, and were ignorant of the attendant benefits, including those for the succession planning process.

Westhead P (2003) 'Succession decision-making outcomes reported by private family companies', *International Small Business Journal*, **21:4**, 369-401

Using a regression model, Westhead examines the characteristics related to whether or not UK family businesses have accomplished a number of succession planning objectives. He finds that most CEOs are actively aware of the need for planning, and the need to facilitate discussion among family members; family firm boards seek to fulfil both 'family' and 'business' agendas; independent external advisors aid in defusing conflicts between the CEO and the family; and that, as firms become larger and more complex, family boards become more 'professional', in order to ensure family continuity.

He also finds that external environmental conditions (e.g. location, market turbulence) exert considerable influence on the succession process.

Westhead P, Howorth C & Cowling M (2002) 'Ownership and management issues in first and multi-generational family firms', *Entrepreneurship and Regional Development* 14:3, 247-69

The authors examine the differences in management practices and personnel between first-generation and multi-generational family firms in the UK, using a matched sample methodology. They find that, in both types of family company, management teams are small, and CEOs tend to be drawn from within the family. Multi-generation firms were more likely to have a non-executive director, and employ external expertise, were generally better-managed, and had longer 'apprenticeships' for their CEOs. The implication is that multi-generation firms are more likely to experience smooth successions, and policy should be directed towards impressing on first-generation firms the need to look outside the company for support.

A9. Other sources

Bank of Scotland (2002) 'Small businesses face uncertain future', press release, 16th October

A relatively brief summary of the results of a UK-wide survey (no further details provided and which has apparently not been published in full), conducted as part of an awareness-raising campaign by the Bank. The survey found that two-thirds of SMEs had no written succession plan. Those in Scotland and the South of England were the least likely to have one (around 30% of managers, compared to nearly half in the North and Midlands). Perhaps more surprisingly, 82% of owner-managers over 56 had no plan, despite the fact that many hope to retire early. Younger managers are more likely to have a plan (e.g. 36% of under-45s).

Bowman-Upton N (1991) *Transferring management in the family-owned business*, working paper, US Small Business Administration Emerging Business series

The author supplies a folksy how-to guide for SME owner-managers on the issues relating to succession. The guide summarises, in practical terms, the main points covered in other articles: family and strategic planning, choosing and preparing a successor etc. It also includes a detailed guide to tax deferral and exclusion techniques, but from an entirely American perspective.

Burke F (2003) 'Effective SME family business succession strategies', Paper presented at the International Council for Small Business, 48th World Conference, Belfast, UK

The author draws on his experience in management in numerous American companies to pass on effective succession strategies for family businesses, concentrating on enablers and processes. An ideal succession plan should identify the most capable successor and ways to attract and retain talented family members and staff; manage change and the retirement of the owner; and involve the Board. The processes this leads to are: (a) understanding the need for, and implementing a plan, across the whole company; (b) identifying critical workforce elements, including the Board; (c) identifying baseline performance and gaps in the workforce, including business/lifestyle priorities for the family; (d) identifying successor candidates; and (e) training and development. All key stakeholders need to be involved, and the author considers that independent board members and outside experts are essential to the process.

Deloitte & Touche (2002) *Business Succession Planning 2nd edition*

A lengthy how-to guide for businesses, with some good examples of the practicalities of ensuring successful transition. The comprehensive guide takes owners through the need for planning, business continuity, family dynamics etc. within an underlying framework of Critical Issues Assessment.

Enterprise Directorate General/BMWA (2002) *European Seminar on the Transfer of Businesses, 23-24 September 2002*

This seminar on transfer methods largely eschewed academic approaches, instead concentrating on workshops to disseminate details of best practice schemes and the response of the market to changes in tax regimes and other policies, highly specific to individual countries. (The one exception was Voithofer's paper, described fully elsewhere in this bibliography). The lessons that emerge from the workshops were summarised by Heinz Zourek (Enterprise Directorate-General) as (a) raising awareness of all key stakeholders and contributors to the business transfer process is key; (b) that professional support is important, but 'transfer of businesses could become a business of its own', with minimal subsidy from government; Zourek's opinion is that this situation is virtually already there; (c) there must be a holistic approach to the whole process, due to the emotional aspects. Furthermore, since transferring businesses outperform start-ups and employ more staff, on average, recommendations to commit as many resources to transfers as to start-ups are sensible from a policy perspective.

Enterprise Directorate General (2003) *Transfer of businesses – continuity through a new beginning, final report of the MAP 2002 project, European Commission*

The Best project expert group reported, in summer 2002, that 610,000 European SMEs, a third of the total, would be changing hands in the subsequent ten years, affecting around 2.4m jobs. The MAP project aims to report on the follow-up to the recommendations set out by the Best project and (subsequently) the Commission, and compare how different countries are structuring their interventions in the business transfer market. It is found that there are still deficiencies in policy co-ordination, encouraging timely preparation, devoting similar resources to transfers as start-ups, and marketplace facilitation. The UK has implemented five of the six Commission Recommendations, but no measure is given of the UK

response to Best recommendations. The UK is also missing from the final progress round-up.

European Commission (1994) *Commission Recommendation on the transfer of small and medium-sized enterprises, 94/1069/EC, 7th Dec 1994*

A response to perceived problems in the business transfer market, this outlines the actions which the Commission envisages to be required to make it more efficient, and the likely (broad) policy responses. The main recommendations include: raising awareness of the need for succession planning among SMEs; revising laws and procedures relating to incorporation, taxation and inheritance to make them more amenable to small firms and partnerships, particularly in relation to the continuance of the business after the departure or death of one of the owners.

European Commission (2003) *Helping the transfer of business – a 'good practice guide' of measure for supporting the transfer of business to new ownership, Office for Official Publications of the European Communities*

A guide to good practice, mostly consisting of examples of support organisations and schemes from across the European Union, to overcome the three identified obstacles to succession: insufficient preparation, complexity of the process and national legislation. Progress on the 1994 EC communication on SME transfer is also examined, revealing that only around half of the 21 recommended measures had been fully put into practice, with take-up varying considerably across countries. The abundant available support is not well structured, and not necessarily reaching its target audience, necessitating an initial concentration on raising awareness. The report's recommendations include a European business transfer centre, online database and marketplace, with similar arrangements at a national level; regular business transfer events to exchange best practice; tailor-made management and training tools; public support for and research on business transfer; and equivalent attention paid to transfer as to start-ups.

Flores-Romano MG (2004) *Survival of the Small Firm and the Entrepreneur under Demand and Efficiency Uncertainty, Warwick Economic Research Paper No. 700, University of Warwick*

In an attempt to account for the prevalence of owner-managers' continued entrepreneurial behaviour subsequent to a business failure (as seen in Blackburn & Stokes, 2001), the author constructs a

theoretical model where SME profits are solely dependent on the owner's management skills (as opposed to product development skills etc.) and the demand for the product or service. He concludes that a form of entrepreneurial self-selection exists: only skilful entrepreneurs would wish to establish another firm in the wake of a failure; less skilful ones prefer salaried employment. In such a situation, at the macro scale, firm closures are, effectively, a means of separating the wheat from the chaff, and lead to a more efficient cohort of entrepreneurs. This accounts for the available data, but there is no empirical evidence on whether this is a correct model.

Garcia-Alvarez E & Lopez-Sintas J (2003) 'Coherence between values and successor's socialization: Facilitating family business continuity', paper presented at the International Council for Small Business, 48th World Conference, Belfast, UK

The authors argue that even where formal succession procedures are poor or nonexistent, the alignment and consistency of value systems between incumbent and successor is often enough to facilitate a viable succession. Family business owners are constantly in a process of transmitting values, both personal and business, to the next generation as a part of both their business and personal conduct. This process allows a smooth handover, as the objectives and management style of the incumbent is, effectively imperceptibly, passed on to their successor.

Harvey D (2004) *Keeping it in the Family*, Certified Accountants Education Trust

A guide to best practice for intergenerational transfer, aimed mainly at accountants, but also of use to firms themselves, emphasising long-term strategic planning and action plans, and recognising the conflict between family and business priorities. The author points out that there are eight separate models for family business succession – Crown Prince (single heir), Sibling Partnership, Cousin Consortium, Stop Gap manager, family owner/professional manager, MBO, market sale and asset disposal. This highlights the difficulty of a single support model, and that closure or outside sale may be the only positive option. However, the ninth option – do nothing – is consistently the most popular. Checklists for firms and advisors deal with the details of succession planning, family councils etc., and effectively ground the conclusions of academic articles in everyday practice.

Holmes TJ & Schmitz Jr. JA (1992) *Managerial Tenure, Business Age and Small Business Dynamics*, Discussion Paper, Center for Economic Studies, Maryland

Based on a mid-1980s US Census Bureau survey of small businesses, the authors attempt to disentangle the characteristics of the manager from those of the business in their effects on firm succession. Using managerial tenure as a proxy for the quality of management skills, and holding business quality fixed, they discover that tenure has the largest impact of any of their variables (e.g. education, gender, ethnicity) on the probabilities of transfer or discontinuance. The age of the business also has a major impact, independent of the length of managerial tenure. Non-founder businesses have significantly higher failure rates, while previously having owned a business gives a lower rate of discontinuance.

Mandl I (2004) 'Business transfers and successions in Austria', paper presented at the EISB conference, Turku, 10th September

Drawing on studies conducted by the Austrian Institute for SME Research (see Voithofer, 2002), the author notes that around a quarter of Austrian businesses will face a transfer between 2003 and 2012, mostly micro and craft and transportation firms. Although some of the challenges facing entrepreneurs derive from 'framework' conditions (structural changes in the economy etc.), others can be 'easily avoided', if the company is fit for transfer, and the transfer is well-planned, with support from external advisors. Although Austria has had some success with recent support measures, they could be taken further, the author argues. She recommends awareness-raising programmes centred in micro businesses; improving the transparency of markets and support measures; incorporating business succession modules into relevant training courses; emphasising that transferability is part of strategic business planning, and introducing it into consultancy programmes; and facilitating transfer via tax and financial rules.

Tralka DW (2003) 'Business succession: keeping ownership in the family', [www.bizjournals.com/memphis/stories/2003/07/28/smallb2.html]

The author looks at the challenges facing third generation family businesses – a stage reached by only 12% of firms. By then, the family may be more detached from management and lack the perspective

for evolution that an outsider might bring. The article is a how-to guide for owners in this position, recommending the following steps: accurate valuation of the business; start planning early to ensure business survival, family harmony and the maximum financial legacy; designate and groom a successor, preferably a family member with industry and management experience, to satisfy lenders' criteria; choose a transfer mechanism. The author examines Employee Stock Ownership Plans and gifting, as ways to minimise tax burdens, and (taxable) recapitalisation, which may require extra effort.

Vartia L (2004) 'Assessing plant entry and exit dynamics and survival – does firms' financial status matter?', paper presented at the E.A.R.I.E. conference, Berlin, 2-5 September 2004

The author examines a gap in the literature, by looking at the financial characteristics of firms owning entering and exiting plants. She finds that firm-level financial distress is likely to decrease the probability of survival, as are recessions and aggregate-level financial distress.

B

SECTION B

PART ONE

B2

A report on a small number of questions placed in the University of Nottingham's barometer surveys of businesses and business advisers

PART TWO

B8

A report of a focus group with representatives across Government departments and other key stakeholders

PART THREE

B12

Responses to a call for submissions

B

Part one:

Business transfer

Findings from barometer surveys of business advisers
and businesses

B1. UK Business Adviser Barometer (UKBAB)

August 2004

In August 2004, a small number of questions on business transfer issues were put forward for use in barometer surveys of businesses and business advisers to get a feel for current attitudes and behaviour.

The UK Business Adviser Barometer is a monthly online survey of business advisers across the UK. It has been established as a collaborative project between the University of Nottingham Institute for Enterprise and Innovation and the Institute for Business Advisers.

The UKBAB consists of around 12 questions, which are a mixture of topical subjects and quarterly repeated questions to generate trends data.

B1.1 THE SURVEY

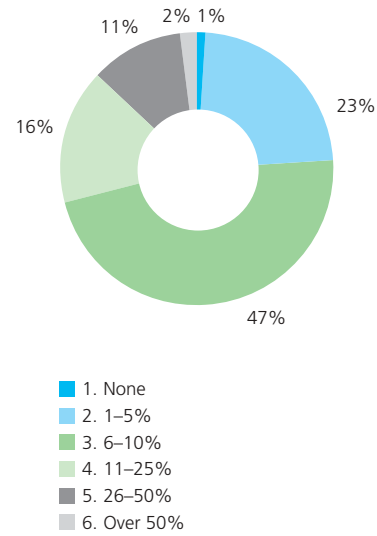
The August survey covered a range of issues, including investment in plant and equipment, reinvesting profits, transfer of ownership, research and development tax credit, holidays and abuse from customers.

210 business advisers responded to this survey. The advisers work across many sectors and client groups, and provide advice across the UK regions. Each adviser may work within several sectors, client groups and regions and may also provide several different types of advice. In terms of their client group, 137 out of the 210 responding advisers suggested that this covered all small businesses.

B1.2 FINDINGS FROM QUESTIONS ON BUSINESS TRANSFER

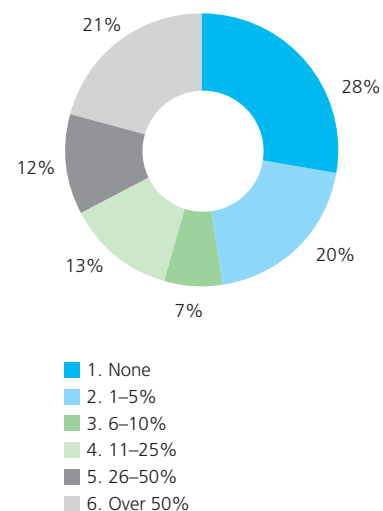
It would seem that only a small proportion of business are sufficiently concerned about transferring all or part of their businesses to consult a business adviser. Around a quarter (23%) of responding advisers had no clients seeking this kind of advice in the last year. Just under half (47%) had requests from only a small number of their clients (between 1% and 5% of their clients). Only 1% of advisers suggested that more than half of their clients had consulted them in relation to this issue.

What proportion of your clients would you estimate have sought advice on a full or partial transfer of their business in the last year?



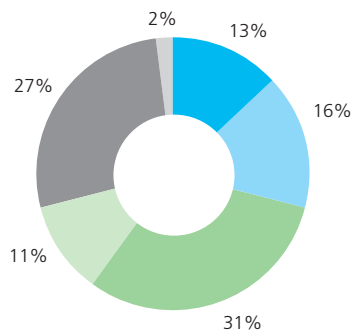
Of those advisers who were involved in a consultation with any proportion (above none) of their clients on business transfer last year, around half (48%) reckon that severe problems are encountered by very few of the clients (5% or less of those advised). Around a fifth of advisers (21%) who had advised on this issue at some point in the last year suggest a much more bleak situation where over half of transfers encounter severe problems.

If you have advised clients on full or partial transfer of their business in the last year, what proportion of transfers would you estimate encounter severe problems?



The advisers were asked for what they saw as key contributors to business transfer failure. The chief reason detected by advisers is managerial dependence on the owner (31% of advisers said this), closely followed by lack of preparation for transfer (27% said this). Poor performing businesses appear in third place, but this was only selected by 15% of advisers. The most common barriers to a straightforward business transfer appear to have been captured by the options offered in the question, since only 2% responded with 'other'.

Which of the following would you suggest are the most common barriers to a straightforward business transfer?



- 1. A business having lifestyle objectives
- 2. Poor performing businesses
- 3. Managerial dependence on the owner
- 4. No family or internal successor
- 5. Lack of preparation
- 6. Other

B2. UK Business Barometer (UKBB) August 2004

The UK Business Barometer survey follows a similar approach to the adviser survey in that it is a monthly online survey, this time of businesses across the UK. The Barometer was originally developed as the East Midlands Business Barometer at University of Nottingham Institute for Enterprise and Innovation.

Again, the UKBB consists of around 12 questions which are a mixture of topical subjects and quarterly repeated questions to generate trends data.

B2.1 THE SURVEY

The August survey asked for views on investment in plant and equipment, reinvesting profits, transfer of ownership, research and development tax credit, holidays and abuse from customers. The 177 responding businesses were distributed across sectors and size bands (turnover and employees) as set out in the tables below.

B2.2 FINDINGS FROM QUESTIONS ON BUSINESS TRANSFER

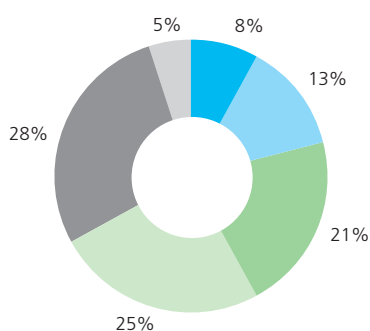
Around a quarter of respondents (26%) are looking at a period of less than five years before a possible transfer of their business and only one in twenty (5%) within the next year. Approaching half of the respondents (46%) consider a transfer to be over five years away. Over a quarter of respondents (28%) simply did not know at which point in the future they may look to transfer.

SECTOR			
Production & Manufacturing	Distribution	Services	Total
25.4%	7.3%	67.2%	100%

TURNIOVER (£)			
<1M	1M-3M	>3M	Total
70.6%	20.3%	9.0%	100%

NUMBER OF FULL-TIME EMPLOYEES					
1-10	11-20	21-50	51-100	100+	Total
57.1%	31.1%	5.6%	3.4%	2.8%	100%

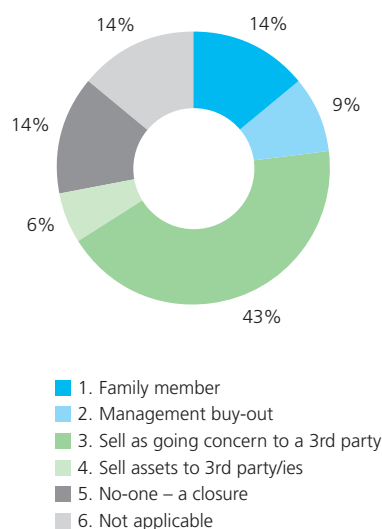
How far off do you anticipate a full transfer of the ownership of your business might be?



- 1. 1 year or less
- 2. Over 1 year but less than 3
- 3. 3 years or more but less than 5
- 4. 5 years or more but less than 10
- 5. 10 years or more
- 6. Don't know

For all respondents, a question was asked about who they anticipated their business might transfer to. Around half (49%) suggested that a third party (independent of family or employees) would take over ownership – 43% overall intending to sell the business as a going concern and 6% overall to sell as assets. 14% of respondents thought that a family member might succeed them, and just under one in ten (9%) thought that a management buyout was likely. 14% of respondents consider it likely that their business will close down and a further 14% consider that this issue is not applicable to them. (Within this relatively limited research approach it was not possible to understand fully the reasons behind some of the responses given.)

Who do you consider most likely to take over ownership of your business when the time comes



Given the small sample size it is difficult to break down responses by size or sector with any confidence. However, there are broad indications that smaller and larger companies (of up to £100,000 p.a. turnover and over £3m turnover) tend to consider transfer is further away. The companies in the £100k-£3m bracket tend to have a shorter timescale in mind.

The objective of selling the business as a going concern is the most popular across the turnover ranges up to £25k and over £100k. For companies with turnover between £25k-£100k, closure is thought to be the most likely outcome, and even amongst companies with turnover of £100k-£250k, a quarter (25%) expect to end in closure.

When looking at the same issues from the perspective of how long the businesses have already been trading, it is apparent that although a higher percentage of the newer businesses are looking to retain ownership for longer, the difference between these and the older established firms is small. It also emerged that those expecting their businesses to close rather than be transferred to others were the newer businesses amongst the respondents. However, selling as a going concern to a third party was still the most frequently chosen category by each 'age' class.

The table below shows the numbers of respondents answering the two relevant questions in the business barometer survey cross-tabulated. The numbers are small and therefore definitive conclusions are hard to draw. However, 28 of the 177 respondents (16%) appear to have no view on the timing of succession or who will take over. They might be considered completely unaware of the business transfer issue or the need to plan. Half of the 24 respondents likely to transfer to a family member see this being at least 10 years away. Those looking to sell their business as a going concern to a third party see this transfer occurring in the medium to long-term – almost half (36 out of 76) expect this to be over five years away.

Number of respondents	How far off do you anticipate a full transfer of the ownership of your business might be ?						
	1. 1 year or less	2. over 1 year but less than 3	3. 3 years or more but less than 5	4. 5 years or more but less than 10	5. 10 years or more	6. don't know	Total
Who do you consider most likely to take over ownership of your business when the time comes?							
1. Family member	1	0	6	3	12	2	24
2. Management buy-out	2	3	1	5	3	2	16
3. Sell as a going concern to a 3rd party	4	8	15	19	17	13	76
4. Sell assets to 3rd party/ies	0	2	0	2	4	3	11
5. No-one – a closure	2	1	0	7	7	8	25
6. Not applicable	0	1	1	2	1	20	25
Total	9	15	23	38	44	48	177

B

Part two:

Business transfer

A report of a focus group with representatives across government departments and other key stakeholders

Leigh Sear, Wood Holmes Group

B2. Focus group – business transfer and succession review group

B2.1 INTRODUCTION

This note provides an overview and summary of the key issues, themes and priorities to emerge from a focus group with Government departments and other stakeholders interested in supporting business transfer and succession amongst the small and medium-sized enterprises.

The focus group took place in London on 15 September 2004, facilitated by Leigh Sear (Wood Holmes Group) and was attended by:

- David Caveliero – David Caveliero Solicitors
- David Collett – Destini Financial Services
- Glen Collins – ACCA
- Danish Chopra – Small Business Service
- Tony Haffenden – Business Link Berkshire and Wiltshire
- Paul Harrod – Small Business Council
- Scott Johnson – Small Business Council
- Helen King – HM Treasury
- Chris Martin – Chris Martin and Associates
- Kirit Patel – formerly of the Small Business Council
- Jim Plunkett – National Family Business Resource Centre
- David Purdy – Small Business Service
- Sheena Sullivan – Small Business Service
- Ola Sunmonu – Small Business Service
- Shaun Sweeney – Company broker
- Emmy Whitehead – Small Business Service
- Mike Young – Bank of England

Building on the review of literature (see Section A1) undertaken by Durham University Business School, the focus group explored two areas, namely a national register of businesses for sale and developing demand for existing businesses. In particular, the focus group was concerned with examining:

- whether there was common ground for action;
- the key challenges or barriers to introduction and implementation; and
- any examples of good practice from elsewhere which would influence introduction and implementation.

Rather than providing a detailed description of the debates within the group, this note highlights the key issues and implications.

B2.2 POLICY OPTIONS

A number of key themes and issues emerged amongst the group in discussing the appropriateness and feasibility of a national register of businesses for sale and ways by which to increase demand through services such as a matching process.

B2.2.1 The National Register

- The key issue to emerge from the group related to whether there is a market failure or market inefficiency in the provision of information to buyers and sellers on potential opportunities for business sales and transfer, and as a result, the opportunities for the public sector to add value to private sector provision and activity.
- There was a consensus that there are currently a number of registers provided by the private sector which are used by businesses (ranging from Daltons Weekly for small businesses to Grant Thornton's for medium and larger concerns). In addition, certain sectors are particularly well-served (e.g. nursing, accountancy, pharmacy) for information on potential buying and selling opportunities.
- At a more specific level, however, an issue emerged concerning the efficiency and effectiveness of the market of existing registers and information services for businesses:
 - of certain sizes (the middle market of businesses with 12 to 50 employees);
 - in particular sectors; or
 - in particular geographical locations.

■ This raises the question of whether there is a national market failure or ‘pockets’ of market inefficiency which could be addressed through public interventions. There was a lack of agreement amongst the group as to whether the failure was at a national or local level. Consequently, there was a lack of consensus over the need for a national register.

■ This is an important distinction. For example, if there are local market inefficiencies, the public sector could add value to private sector activity through bringing together the range of intermediaries with listings and registers which may lead to the development of a portal or searchable database. Models of useful practice could include e-Bay and Right Moves which bring together information to assist the buying process.

■ A secondary group of concerns with the concept related to the practicalities of implementing and operating a national register. Issues were raised around:

- confidentiality of information on the register – and hence willingness of sellers to disclose certain types of information (for example, the register may alert competitors of the business to the fact that the owner-manager is interested in selling or the owner-manager may be selling the business without the knowledge of the workforce);
- the need for focused targeting – as certain sizes, sectors or locations are better served than others by current registers which may increase the cost of operating the service;
- the need to be able to develop recognition and trust with the different stakeholders as the national register being the place to use. This means ensuring that information is reliable and that it captures the right type of opportunities within the market;
- sharing of information between different types of intermediary such as transfer agents, solicitors, accountants or business support agencies; and
- policing of the register to ensure appropriate usage by buyers and sellers and verification of information in terms of levels of trust of different sources. Who would be the appropriate organisation to monitor the register – the Government or the private sector?

■ Hence, a top-down wide-ranging approach may not be suitable or effective in adding value to private sector activity.

■ This issue is related to the issue of a lack of perceived understanding of the process of business transfer and succession amongst different stakeholder groups and the associated ‘need to knows’.

■ There is a general perception that smaller SMEs are not aware of the need to plan for business transfer or succession and the opportunity of business transfer as a vehicle for business growth. This may reflect their motivations and drivers to going into business, their own personal experiences or the type of advice received from their support networks. As a result, there is a perceived lack of seller ‘readiness’.

■ In terms of buyers, a lack of awareness of appropriate financing sources and how to finance business transfer may be suppressing demand within the market.

■ These issues with the demand and supply-side may reflect a focus within public sector business support on start-up activity (as opposed to encouraging small business growth) and the tendency for intermediaries such as accountants to provide reactive rather than proactive advice on the options for business transfer (as opposed to directly handling the transfer). There was a perception that SMEs do not ask for, or receive, advice on business transfer from agencies, including Business Link Operators, as part of discussions on start-up or business growth.

■ As a result, there is a need for the public sector to educate buyers and sellers and assist with capability and capacity building within the intermediary market such as Business Links. For example, when an individual wishes to start a business and they approach Business Link, they could be advised about the issues surrounding business succession and transfer (both selling and buying) as a growth strategy which may over the longer-term increase demand and the size of the market. But this is based upon the advisers receiving professional development support which develops an understanding of business transfer as a part in the growth and development process.

■ In terms of intermediaries, it was suggested that the Government could support a national accreditation scheme of private brokers which would assist businesses in choosing between brokers in terms of relevant expertise and quality. This could be an extension of the Business Link consultant register, although there are gaps of certain type of specialist on the register, for example, in terms of family business.

In summary, there is a:

- need to clarify the nature of the market failure – as this will influence the vehicle for the introduction and implementation of the register. It will also help assess whether the emphasis should be on introducing a ‘new’ register or on collating and co-ordinating existing sources of information;
- need for better education of buyers and sellers to enhance buyer and seller readiness. This could be achieved through more focused advice from advisers to businesses at start-up or early stages of growth and increasing awareness amongst buyers as to potential sources of finance to underpin purchases; and
- need for the public sector to facilitate and add value to the work of intermediaries through, for example, developing a portal or searchable database.

B2.2.2 Developing the demand for existing businesses (e.g. match-making service)

There was less discussion and focus on ways in which the demand for *appropriate* business transfer and succession could be increased. The discussion within one of the groups highlighted the following key issues.

- Demand could be increased by developing awareness within small businesses as to the option of business transfer as an entrepreneurial process and viable route to business development and growth. Focusing on improving understanding of the transfer process would address the issue to tackling behaviour and enhancing transfer as an issue for businesses earlier in their business development journey.
- There is also a need to change attitudes towards borrowing finance to underpin transfer deals.
- The tax regime surrounding business transfers was considered to be complex and negotiating the process presents problems to both buyers and sellers. Modifications to the tax regime, particularly in terms of conversion of value of the business into a beneficial retirement fund could increase demand. Wholesale changes to taxation laws would not be required.

- In terms of finance, a greater number of start-ups buying a business could be facilitated by applying the Small Firms Loan Guarantee Scheme to shares as well as investments. There are examples within particular sectors (such as electrical contracting and the Pharmacy Loan Guarantee Scheme) which provide insights into how to increase demand.

In summary:

- There is a need for intermediaries including business advisers and accountants to work with small businesses to enhance understanding of business transfer as an entrepreneurial process. This could be achieved through the use of case studies, how to guides or experience exchange workshops.

B

Part three:

Business transfer

A summary of responses to a call for submissions

SMALL BUSINESS SERVICE

B3. Responses to a call for submissions and meetings with key stakeholders

B3.1 BACKGROUND

During the summer of 2004 a range of key stakeholders, from businesses, representative groups, professional bodies and government departments or agencies, were asked for their views on the issue of business transfer. They were asked for responses to a series of questions based on their experience or, where possible, a data source. The responses have been summarised below under headings that broadly correspond to the areas of questioning.

Respondents' experiences of business transfer ranged from personal involvement in specific transfers through to an interest in different sectors and business types. A number of respondents stated that their policy or advisory role extended to all types of SME transfers.

The following people/organisations in the table (right) responded to the call for submissions.

B3.2 BUSINESS TRANSFER FAILURE – WHO IS MOST AT RISK?

Responses on this question mixed sectoral or size factors with less tangible issues which might present increased risk of business failure. A number of respondents stressed that failure could happen in all manner of businesses, although the youngest (with little track record), older (family or lifestyle types) and smallest businesses were generally thought to be at more risk.

A theme across a number of responses was that insufficient, or a complete lack of, preparation for succession increased the risk of failure. Businesses most at risk had not drawn together a succession plan or had left it too late. Related to this were concerns that some owners were unwilling to face up to relinquishing control of the business and this added difficulties to the process. Forced sales were said to be more likely to fail, although even this occurrence can be planned for.

The issue of 'goodwill' was a recurrent theme. It can lead to a sticking point on the valuation of a business. Some buyers are concerned about whether the

Company	Name
1. Institute of Business Advisors	Mike Horne
2. Lankey & Co	Malcolm Allen
3. Business Link for Northumberland	Jack Cavgin
4. Yorkshire Enterprise Group	Peter Claydon
5. Wales Cooperative	Norman Watson
6. South West of England RDA	Steve Richards
7. Job Ownership	Patrick Burns
8. Highlands & Islands Enterprise	Jim Mackay
9. Business Link West Yorkshire	Siobhan Barton
10. ACCA	Christopher Arnold
11. Turner Butler	Shaun Sweeney
12. Call North West	Robert Hale
13. Personal	Peter Storms
14. Business Link for London	Keith Gilbey
15. ICAEW	Clive Lewis
16. SBIT	Steve Sharratt
17. Business Link Berkshire and Wiltshire	Tony Haffenden
18. CBI	Nicholas Bojas
19. British Retail Consortium	Kevin Hawkins
20. Invest Northern Ireland	Ann-Marie Anderson
21. Business Link Lincolnshire & Rutland	Gaye Woodward
22. Personal	Fiona Price
23. Business Link for London	Bill Mowbray
24. SBC member	Peter Donaldson
25. SBS member	Sue Brownson OBE
26. Personal	Graham Wood
27. Chris Martin & Associates	Dr Chris Martin
28. The Regional Finance Forum of AMW	Norman Price
29. The Tax Expert	Ilyas Patel
30. Federation of Small Businesses	Nick Hamper

business's customer base will be brought across in the process. Some fear that the owner will take customers with him/her. In the manufacturing sector in particular, ensuring the continuation of the supply chain was considered important. For innovative and technology businesses, difficulties could arise where intellectual property rights were unclear or not secured.

Goodwill is essentially an outward facing issue for a business. Looking inward, businesses built around human capital, particularly within creative industries, can have difficulties in a transfer. A buyer will want some assurance about the retention of the human capital that gives the business its value. There will also be concerns where the business has been very dependent on the skills or personality of the incumbent owner.

Some further points were made that businesses can be very difficult to sell because of the poor quality of their accounts or the performance of the business. Inevitably some buyers will look for a real potential for growth and these factors would be off-putting.

B3.3 SCALE OF TRANSFER ACTIVITY

In terms of how many businesses consider the possibility of transfer within a given year, estimates varied a good deal. Figures were offered in the absence of a reliable data source. A number of respondents estimated that the level of businesses considering transfer was around 10% or 20%, a few suggested a higher or lower percentage. A number felt the cost of advice was a deterrent to 'just considering'. Some respondents suggested that certain sectors attracted more owners who are close to retirement age or more owners looking to grow a business and sell relatively quickly.

In terms of how many businesses actually transfer ownership, again estimates seemed hard to substantiate. The most common viewpoint seemed to be that the level was around 1% of all SMEs and only a minority of those who have thought about it.

B3.4 BUSINESS TRANSFER AS AN ALTERNATIVE TO START-UP

Respondents were strongly of the view that a business transfer offers a real and potentially rewarding alternative to starting up a business from scratch. It was considered a much under-used approach. The franchise model was cited by some as indicative evidence of demand, although a number of respondents could point to examples where businesses were taken over to achieve a considerable capital gain or a more immediate revenue stream. As a minimum, a transferred business was considered more sustainable than a start-up.

It was suggested that the skills needed to start-up a business are different from those needed to takeover an existing business. As the latter may require a new owner to hit the ground running, one respondent suggested a staged transfer might help. However, beyond an inter-generation family transfers a staged process was considered to be, as yet, unpopular with people wishing to start in business. Others suggested that this was not even a possibility with the smallest of businesses and at this lower level people were keen to start-up from scratch with all their own ideas in place.

"Very few consider business transfers as an option due to lack of access to finance, market intelligence and availability. However, in theory these types of businesses should be easier to finance compared to start-ups. This is because of the existing track record which suggests that the business is less likely to fail." CBI

B3.5 IMPACT ON STAFF, SKILLS AND TRAINING

Respondents struggled to offer evidence that there would be considerable job gains or losses from business transfer activity. Much was thought to be dependent on the state of the business or the economic climate within the sector, region or country. Inevitably, some transfers would lead to efficiency savings being sought from the business but there is also the potential for increased growth and, in turn, additional demand for labour.

More broadly, the unsettling effect of a transfer on employees was recognised. Well-timed communication was considered key to avoiding staff 'jumping ship'.

"In reality, there is very little impact. However, it is invariably perceived by the employees as being a threat to their livelihood, and can be very unsettling. It causes uncertainty and a feeling of rejection within many businesses." Business Link – West Yorkshire

The effect on staff training and skills development was considered hard to judge as much was dependent on how the transfer was financed. The most common view was that, in the short term, activity may be suspended, but in the longer term arrangements may even improve.

B3.6 CUSTOMERS AND SUPPLIERS

A number of respondents suggested that there were significant risks in business transfers around retaining customers and suppliers. A transfer strategy would need to include an approach for early communication or engagement with these groups.

“ Customers will usually give the new owners a chance and if quality of product/service/support remain unchanged/improve they will remain loyal. If these factors decline, they will use the ‘change’ as an opportunity to review their needs and source elsewhere. Suppliers will be more nervous, and may well tighten trading conditions until a track record is established. It can thus have a negative impact on cash-flow of new proprietors.”
South West RDA

B3.7 OTHER IMPACTS

The impact of transfer on the fixed assets was thought to be quite specific to sector or the nature of the business involved. Some respondents saw potential for a decline in investment in fixed assets as an owner sees a transfer looming. Some saw increased investment in the fixed assets by the new owner. However, this was thought to be dependent on the availability of funds after the purchase and whether leasing arrangements for the property and equipment are agreed as an alternative to outright purchase.

Again, views on research and development suggested that there was potential for decline before transfer and increase after. However, much was dependent on size, sector and growth potential of the business and the financing of the purchase.

The impact on the financial position of the transferred business was considered largely dependent on the structure of the acquisition. However, the majority of respondents would anticipate an improvement.

B3.8 SALEABILITY

There was some agreement with the view that businesses with lifestyle or personal objectives can struggle to find a buyer. However, this was balanced by some claims that many lifestyle objectives can still be valid strategic goals for a business. In the end, good businesses will sell.

Views on the effect of the financial performance of the business on saleability were mixed. There seemed general agreement that the strength of the business would simply be reflected in the price. The incumbent can have an inflated view of the value based around the effort they have put in to building a business. It is also the case that very successful businesses can be highly priced with little scope for negotiation or significant development following

purchase. Conversely, very poor businesses can be sold for just their physical assets.

On the issue of whether having an owner-manager or executive management team makes a business sale easier, there was a tendency for respondents to suggest that the emotional ties of the owner-manager to the business could make the transfer harder to execute. In some cases, this could in turn be compounded by the absence of a family successor, making the sale feel somewhat forced upon the owner. Family succession was felt to be ‘increasingly rare’.

B3.9 FACILITATING THE TRANSFER

Almost unanimously, preparation, or the lack of it, was considered significant in the success of business transfer. Many owners were thought to be putting themselves at a disadvantage by having no documented plan and some were even thought to avoid contemplating that a transfer must happen until it is upon them.

Accountants were seen as important, indeed, a necessity in the transfer process. Some suggested that they are under-used. Where there was perhaps some difference in responses was the full scope of their role, the smaller accountancy firms were said by some to be unsuitable for comprehensive transfer support – e.g. sales and marketing.

Company brokers were not seen as playing a significant role except in particular sectors. Some saw a problem in their vested interest in increasing the sale value.

Responses were also a little mixed on business transfer agents, except from agents themselves. Again they were thought more likely to operate in certain sectors.

“ Business transfer agents are primarily involved in transferring smaller, usually occupation-based SMEs, such as hotels, post offices, hairdressers etc in sectors where there are steady flows of incoming and exiting owners.”

Chris Martin Associates

Business Link Operators were considered to play a minimal role, although this may vary somewhat across regions. Some criticised their level of expertise on this issue.

B3.10 IMPROVING THE BUSINESS TRANSFER

Respondents were asked what could be done to improve business transfer processes in the UK. The general thinking that something more is needed but answers varied considerably. Whatever is done would need to reflect diversity of the whole SME population. A selection of issues is set out below:

Information – more might be done in terms of raising awareness of the need to plan for succession. More might also be done to alert people to the potential for employee ownership.

Coordination – more might be done to facilitate transfers that take place. A register of businesses for sale was mentioned by some respondents. Others raised the potential for some body to mediate the process so that relevant players are brought together and understand their respective roles.

Technicalities – some respondents pointed to some quite technical problems that, if adjusted appropriately, might help. These related to:

- the rules around the Small Firms Loan Guarantee Fund and financing management buyouts
- rules around shareholding and achieving consensus for transfer;
- with bigger SMEs, the transfer of pension liabilities for a large number of employees; and
- with vendor financing, whether this is treated as revenue or capital.

