SME POLICY FACED WITH DEVELOPMENT OF FINANCIAL TECHNOLOGY

Business Transfer as an Engine for SME Growth

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Abstract

Business transfer represents a critical stage in the life of many SMEs. With the ageing of the population in many OECD and G20 countries, the volume of business transfers is expected to increase sharply. Successful business transfer of economically sound SMEs is crucial to retain employment, drive business dynamism, ensure continuity in production processes and business relations, and preserve the value of assets. There is a need to improve the evidence base on business transfer trends in order to provide appropriate support; raise entrepreneurs' awareness of the importance of early succession planning and of acquisition opportunities for new entrepreneurs. Many countries have recognised the importance of the issue and are taking action to improve business transfer conditions.

Challenge

Many economically sound SMEs discontinue their activity or lose competitiveness and value as a result of problematic business transfers, with negative effects for the growth and innovative potential of economies, job creation and retention, as well as for the cohesion of communities and regions. In the coming years, with the ageing of entrepreneurs, the volume of business transfers is expected to become increasingly significant in many OECD and G20 countries. In the European Union, for instance, around 450,000 SMEs change ownership annually, affecting more than 2 million employees. However, up to one third of these transfers may not be successful, thus endangering around 150,000 enterprises and 600,000 jobs (European Commission 2012).

In Japan, more than 300,000 SME incumbents will attain the age of 70 within the next five years. At the same time, about one fifth of Japanese micro firms consider that it is unavoidable to discontinue the business in one's own generation, and approximately 70% of those managers, who think that business closure is unavoidable, have come to this conclusion without actually considering the possibility of business transfer (Small and Medium Enterprise Agency, 2014). In Italy, about 9% of entrepreneurs are over 70. In Austria, 27% of all SMEs in the industrial economy, accounting for 30% of employment, are expected to be handed over in the period from 2014 to 2023 (Ziniel et al. 2014). In Canada, approximately 50% to 60% of business owners will retire over 2017-27 (Bruce and Wong 2012). In Switzerland, as of 2013, 22% of SME incumbents intended to pass ownership over in the next five years, and 25% were seeking to hand the leadership position over (Christen et al. 2013). At the same time, the number of potential successors per SME executive director is expected to drop from 4.3 in 2016 to 3.4 by 2030 (Andric et al. 2016).

Furthermore, in former socialist economies in Central and Eastern Europe, the first generation of entrepreneurs is nearing retirement, leading to a significant proportion of the business stock having to be transferred in the coming years. These challenges are often exacerbated in rural areas, where urbanisation trends make it more difficult for business owners to find eligible successors. Successful business transfer of viable SMEs at different stages of their life cycle is crucial to retain employment, preserve the value of tangible and intangible assets, ensure continuity in production processes and business relations, and avoid disruption in well-functioning local production and service provision structures. Business transfer may also provide a means of exit for successful entrepreneurs, through the sale of start-ups to other entrepreneurs or firms. Furthermore, business transfer can represent an opportunity to rethink a firm's strategic vision and business model, innovate and seize new opportunities, as well as for new entrepreneurs to enter the market (Brigham et al. 2007).

Business transfer is a complex task and a rare occurrence in the SMEs life cycle. To provide adequate support to transferors and transferees in the preparation of the transfer process, there is a need to improve the evidence base on business transfer trends; raise entrepreneurs' awareness of the importance of early succession planning and of acquisition opportunities for new entrepreneurs; support the development of business transfer markets and appropriate mechanisms for the valuation of enterprises; tackle administrative burdens and regulatory complexities; consider tax consequences on sale or disposal of SMEs; and ensure an appropriate financing offer to ease the transfer.

Proposal

Business transfers are commonly understood as the transfer of ownership, and in most cases of management, of a company to one or more legal entities or natural persons (e.g. Mandl and Voithofer 2004). They can often be a complex matter due to the many different transfer options, the large number of parties typically involved and the variety of regulations that apply. Financial and administrative requirements often add to the regulatory and management challenges.

Identifying factors for successful business transfer and conducting a stocktaking of good practice policies

There is no blueprint for a successful business transfer. Its success usually depends on a great variety of factors, including individual ones related to the transferor and the transferee (e.g. motivation, abilities, attachment to the company), inter-relational factors (e.g. conflicts among family members), financial factors (e.g. availability of financial resources, ability to sustain tax burden), contextual factors (e.g. market conditions), and process-related factors (e.g. formalised criteria to choose the transferee) (De Massis et al. 2008). Some evidence suggests that relevant successor-related factors that influence satisfaction with and success of the transfer process include, among other things, the willingness of the successor to take over, the relationship between the owner-manager and successor, as well as the preparation level of the successor (Venter et al. 2005).

It is the responsibility of the parties involved to properly arrange the transfer process. However, targeted policy measures can support them in managing this important undertaking.

In recent years, many countries have recognised the importance of improving the conditions for SME business transfer and taken action in different areas. For instance, at the European level, business transfer issues are specifically addressed by the EU Small Business Act, and easing business transfer is indicated as a priority in the Entrepreneurship 2020 Action Plan. As early as 1994, the European Commission also issued Recommendations on the transfer of small and medium-sized enterprises (European Commission 1994, 2012).

In addition, a variety of strategies and instruments are being developed by national governments, as well as by business organisations focusing on business transfer and family businesses, to ease SME transfer conditions. These include awareness raising, special financial facilities designed to finance transfers, legal transformation (notably the possibility to create public limited companies facilitating the selling of a firm), as well as transparent markets for business transfers. The G20 could undertake a stocktaking of business transfer policies which would identify good practices, covering several areas for consideration which are outlined in the sections below.

Improving the evidence base

Failures in business transfer are driven by a combination of factors. However,

in the absence of current and representative statistical data, due also to different definitions and data collection frameworks across countries, the mortality or survival rates of businesses before and during transitions remain largely unknown.

Despite considerable progress in research on business transfers in recent years, better evidence is needed to monitor business transfer processes across countries, sectors, firm typologies and entrepreneurs' characteristics, assess the main causes of transfer failure and main impediments to cross-border transfer, and identify the levers for successful transmission in different contexts, including the growth performance of transferred firms and the impact on jobs. Empirical analysis is particularly absent in the case of family businesses, and research has largely remains in an evolutionary stage, although recent years have seen an increasing interest in these types of firms (Brockhaus 2004; Benavides-Velasco et al. 2011). In addition, a better understanding is needed of the key factors that can help utilise the transfer process as an entrepreneurial opportunity, where both the entry of new owners and exit of old owners are associated with the pursuit of new business opportunities (Nordqvist et al. 2013).

The G20 countries and relevant international organisations could study the feasibility of a coordinated effort to improve data on business transfer trends and forms. Efforts to strengthen the evidence base could draw on national and international data collection exercises, data gathered by stakeholder groups and others, as well as through a survey of already existing, related literature. A better understanding is also needed of the implications of various tax issues for SME business transfer.

Planning for both expected and unexpected transfers entails many complexities

While the retirement of the business owner is one of the main reasons for the business transfer, other drivers include unforeseen events, such as illness, death, or sudden incapacity of the owner to continue to run the business, but also the pursuance of other career opportunities by the entrepreneur, or the sale of the business to set up a new enterprise.

In particular the absence or delay in transfer planning for both cases – the regular (e.g. retirement) and the unexpected (e.g. illness) transfer –challenges the transferability of enterprises, as the process is in most cases a unique event in the transferors' and transferees' life, for which they have no or only little experience. Owners of SMEs often begin to deal with their own withdrawal relatively late. For instance, a recent survey conducted by the Family Firm Institute illustrates that while 79% of family-owned businesses plan to transmit the management within the family, only 16 % of these firms have prepared a consolidated family succession plan (Family Firm Institute 2017). Proper preparation is all the more necessary if the business operates across different countries, since different local operating conditions and business relations increase the amount of "managerial know-how" that must be acquired and mastered by the new owner.

One of the major challenges for SME business owners is the identification of a capable and willing transferee, as well as an appropriate form of transfer, which may include the succession to family members, transfers to employees (Management Buy-Out, MBO), sales to other enterprises (Management Buy-In, MBI; mergers and acquisitions, M&As), initial public offerings (IPOs), and transfer of ownership to foundations or combinations thereof.

Incumbents of family businesses often strive to keep the business ownership within the family (Handler 1994). In Switzerland, for example, more than 40% of the current incumbents took the business over from a family member (Christen et al. 2013). In the Netherlands, 73% of those family businesses that have undergone a business transfer report a family relation between the former and the new business owner (Flören et al. 2010). However, non-family transfers have increased in recent years, and will likely gain further importance in the future in many OECD and G20 countries, due to the decreasing number of family descendants; the wider access to education by youth, leading to more career options outside the family firm; and greater involvement by descendants of business owners in succession decisions.

The decision to transfer the business to a family member or to an outsider may yield different economic results. In France for instance, firms transferred to a family member or to an employee tend to have higher employment rates than in the case of business transfers to outsiders, whose new strategy tends to be more growth-oriented. In addition, family business transfers have a higher survival rate after three years (Bastié et al. 2018, Nougein and Vaspart 2017).

However, the identification of a successor is a major obstacle in planning the business transfer. More than half of Canadian SMEs face this problem (Bruce and Wong 2012). In Switzerland, the number of potential successors per SME executive director is expected to drop from 4.3 in 2016 to 3.4 by 2030 (Andric et al. 2016).In some cases, profitable SMEs simply do not find a successor, and governments have therefore started promoting alternative options for business succession (Lewis 2017). For instance, in Japan, the government is seeking to leverage M&As as a solution for SMEs facing succession issues. Cooperation is being strengthened not only with Business Succession Networks and SME support organisations, but also with Business Succession Support Centers. Businesses are encouraged to realise early and systematic business succession, and the framework for business matching support, such as through small-scale M&A schemes, has been strengthened (Small and Medium Enterprise Agency 2018).

Raising awareness

National awareness campaigns have proven useful to inform (upcoming) entrepreneurs through brochures, seminars, innovative digital tools such as webinars and social media, as well as through personal consultations. Governments from OECD and G20 countries have launched numerous initiatives in recent years. Business transfer awareness raising activities in Finland, for example, consist of a variety of measures, including activation letters, events, calls and visits. These activities are mainly implemented by FFE with its regional associations, MEE, and municipalities. Ageing entrepreneurs are the dominant, but not the only target group (Viljamaa et al. 2015).

Regionally located tax, financial and legal experts, as well as chambers of commerce and business development agencies, are well placed to provide necessary information. In this regard, appropriate training of the professionals involved can contribute to improve knowledge. In addition, incumbents of all ages need to be made aware of the importance of planning for business transfers in case of emergencies. Useful tools include "emergency kits", which can facilitate smooth transitions in case of sudden events, comprising, for example, copies of important documents such as testament, business agreements, life insurances and essential passwords for accessing business systems (Transeo AISBL 2014).

Increasing the number of (potential) transferees through different means of support

Fostering contacts and information exchange with potential new founders regarding the possible takeover of established companies, as well as promoting entrepreneurship among all segments of the population, including among disadvantaged and/or underrepresented groups such as women, youth, ethnic minorities or migrants, can contribute to addressing "transfer gaps" (OECD/European Union 2017). Online marketplaces for business exchanges have been set-up in recent years, including by the private sector. For instance, in Europe, an association on SME transfer was created in 2010, Transeo, which gathers public and private operators in the SME transfer market, with the aim to promote collaboration and exchange of information and good practices (Transeo AISBL 2019).

Ensuring appropriate financing conditions

The takeover of established businesses often requires financial capital, e.g. for paying the sales price, or undertaking necessary investments. The transferees of smaller businesses typically rely on personal resources (beyond the company's equity), when a transfer or selling takes place (OECD 2017). However, when costs are not directly related to the entrepreneurial activity, such as compensation payments to family members, an additional financial weakening can occur. National legislation on personal guarantees for obtaining a bank loan, for instance, can pose a hindrance to financing the transfer, as in some countries like Japan, personal guarantees by the business owner or his/ her family members are often not sufficient.

Approximately every second Canadian SME owner, for instance, ranks obtaining the necessary financing for a takeover among the top barriers of transfer planning (Bruce and Wong 2012). Even if the necessary amounts are usually not very large on average, transferees can experience difficulties in raising finance. Almost 43% of German transferees, for example, invest up to EUR 10,000 and almost 33% up to EUR 25,000 in a business transfer (Ullrich and Werner 2013).

In some countries, development banks or public financial institutions provide a range of mezzanine or subordinated loans to enterprises that change ownership. Specific loan programmes, including micro-credits for young, first time entrepreneurs taking over a business are also used to ease the financial burden associated with a business transfer. For instance, "take off loans" to young entrepreneurs are offered by Finland's public development institution, Finnvera, and by the French *Réseau Entreprendre*, a private association running a regional network with the participation of public partners. Although it currently accounts only for a limited number of operations by SMEs, venture capital can also serve transfer purposes, in particular for financing MBI (Management-Buy-In) and MBO (Management-Buy-Out). In Denmark, for example, a dedicated matching online site supports buyers that seek additional equity from venture capital firms (OECD 2017). Disseminating information about available instruments, including a clear description of eligibility conditions, along with contact details, can help increase the use of existing programmes.

Considering tax consequences on sale or disposal of SMEs

Taxation regimes may also have an impact on decisions relating to SME business transfer. For example, some research has found a strong relation between succession taxes and the decision to sell or keep the firm within the family (Tsoutsoura 2015). Several OECD countries have introduced preferences targeted at SMEs under gift and inheritance taxes, with the aim to address adverse tax consequences, including on retirements savings or intergenerational transfer of assets, and ease business transfer (see Appendix). At the same time, the introduction of preferences on the disposal of SME assets should be considered against the revenue and efficiency costs of doing so, including the risk of creating further distortions, such as discrimination against transfers of private wealth relative to transition of business ownership (OECD 2015).

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Appendix

Gift and inheritance tax preferences in selected OECD countries

Germany provides an exemption from gift and inheritance taxes if the successor continues to hold the business and keeps the wage bill steady. This requirement is relaxed for SMEs so that they only need to continue to hold the business.

Hungary exempts the inheritor or donee of the SME's assets from stamp duties or gift taxes, depending on the number of employees and net sales revenue.

Italy allows transfers of firms or shares to the spouse or descendant to be exempt for inheritance tax if the activity is carried on (or for shares, if control is retained) for five years.

In **Japan**, there are various measures to ease the transition of the business, including reducing the taxable value of sites for business under the inheritance tax by 80%, up to a limit of 400m2, deferment of inheritance tax payments and gift tax on unlisted shares.

The Netherlands provide a provisional exemption for inheritance taxes of businesses that are continued for at least five years. This exemption applies at 100% up to a going concern value of EUR 1,045,611 (in 2014) and at 83% for values above this amount.

With respect to closely-held businesses, the **United States** allows estate tax to be paid over a 10 year period if the value of the business exceeds 35% of the estate and the owner had an interest of at least 20% in the business. Only the tax relating to the interest in the business may be deferred. The United States also allows a special use valuation for real property used as a farm or in another trade or business, allowing them to be valued for estate tax purposes at actual use rather than highest and best use. This can decrease the value of the asset by up to a maximum of USD 750,000, which is adjusted for inflation since 1997.

Belgium also provides preferences under gift taxes, although these are levied at the regional level.

Source: OECD 2018.