Business transfer as an engine for SME growth
Parallel session 2
Background information

This paper was prepared as a background document to the OECD Ministerial Conference on Small and Medium-sized Enterprises, taking place on 22-23 February 2018 in Mexico. It sets a basis for reflection and discussion.

About the Ministerial Conference

The 2018 OECD Ministerial Conference on Strengthening SMEs and Entrepreneurship for Productivity and Inclusive Growth is part of the OECD Bologna Process on SME and Entrepreneurship Policies. The Conference will provide a platform for a high-level Ministerial dialogue on current key issues related to SMEs and entrepreneurship. It will seek to advance the global agenda on how governments can help strengthen SME contributions to productivity and inclusive growth; how SMEs can help address major trends and challenges in the economy and society; and how the OECD the support governments in designing and implementing effective SME policies.

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2018 SME Ministerial Conference

Business transfer as an engine for SME growth

Policy note
Summary

- Many economically sound SMEs exit the market as a result of problematic business transfers, with negative effects for the growth and innovative potential of economies. In the coming years, with the ageing of entrepreneurs, the volume of business transfers is expected to become increasingly significant in many OECD countries.

- Successful business transfer of viable SMEs at different stages of their life cycle is crucial to retain employment, preserve the value of assets and ensure continuity in production processes and business relations. 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.

- Business transfers can be a complex matter due to the number of parties typically included in the process, the need for business valuation, and the variety of regulations that apply. Financial and administrative requirements typically add to the regulatory and management challenges.

- In recent years, governments have taken action to improve the conditions for business transfer, such as through gift and inheritance tax preferences, special financial facilities, and the development of platforms for business transfer.

- There is a need to improve the evidence base on business transfer trends; raise entrepreneurs’ awareness of the importance of early succession planning and acquisition opportunities for new entrepreneurs; support the development of business transfer markets; tackle administrative burdens and regulatory complexities; consider tax consequences on sale or disposal of SMEs; and ensure an appropriate financing offer to ease transfer.

Questions for discussion

1. What can governments do to create conducive framework conditions for business transfer?

2. Which targeted measures may be most effective to address the transfer challenges of small businesses?

3. What are the main knowledge gaps with regard to business transfer conditions and trends?
Why does it matter?

Business transfer\(^1\) represents a critical stage in the life of many small businesses, which the ageing of the population of entrepreneurs has brought to the fore in many OECD countries. In Japan, for instance, more than 300 000 SME incumbents will attain the age of 70 within the next five years according to recent figures by the Ministry of Economy, Trade and Industry. 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. 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). 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.

Against this backdrop, a significant number of economically sound SMEs disappear from the market as a result of problematic transfers, with implications for economic growth, employment, innovation and social inclusion. In the European Union, for instance, around 450 000 SMEs change ownership annually, affecting more than 2 million employees, but up to one-third of these transfers may not be successful, thus endangering around 150 000 enterprises and 600 000 jobs (European Commission, 2013). In Japan, about one fifth of 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 (Government of Japan, 2014). The challenge is exacerbated in rural areas, since urbanisation trends make it more difficult for business owners to find eligible successors.

While the retirement of the business owner is one of the main reasons for the business transfer, other drivers include the pursuance of other career opportunities by the entrepreneur, the sale of the business to set up a new enterprise, or unforeseen events. In all cases, closures of economically viable SMEs as a consequence of problematic business transfers can induce job losses, domino effects on local enterprises and suppliers, and the loss of specialised knowledge. Failed transfer processes also negatively affect the individual entrepreneur and his/her family, such as through the forfeiture of family assets. Furthermore, unresolved transfer arrangements can harm ongoing and future business prospects, such as by unsettling business partners, customers and suppliers. For instance, pending transfer planning may induce customers to refrain from business deals, due to uncertainty over the firm capacity to guarantee supply in the long-term. Also, financial institutions may be induced to downgrade creditworthiness (Schlepphorst, 2016).

\(^1\) Business transfers are commonly understood as the transfer of ownership of a company to one or more legal entities or natural persons.
Successful business transfer of economically sound SMEs is crucial to retain employment, ensure continuity in production processes and business relations, and preserve the value of tangible and intangible assets. Furthermore, business transfer can provide an opportunity to rethink the strategic vision and business model of the enterprise, and to introduce innovations and new management practices. Business transfer may also represent an opportunity for new entrepreneurs to take over a business (Brigham et al., 2007).

**What are current trends and challenges?**

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 mergers and acquisitions (M&As) (i.e. sales to other enterprises), initial public offerings (IPOs), transfer of ownership to foundations, and the succession to family members. For example, more than half of Canadian SMEs view the identification of a successor as a major obstacle in planning the business transfer (Canadian Federation of Independent Business, 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 the case of family businesses, entrepreneurs often strive to keep the business ownership within the family. 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 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.

Business transfer can also take the form of transfer to individuals who are employed in the company, such as employees (i.e. Employee-Buy Outs - EBOs) and executives (i.e. Management-Buy Outs - MBOs), whose knowledge of the company and the business owner generally facilitates sales negotiations. However, the lack of a second executive in most smaller enterprises makes MBOs relatively rare. Also, the short “cognitive” distance between these insiders and the established business model can prove detrimental if strategic realignments are necessary. In contrast, individuals who are external to the business can often make such changes more easily, such as in the case of acquisition by a private and non-self-employed person (i.e. Management-Buy-In - MBI), although a longer familiarisation period for the new owner to understand existing structures and procedures is typically required.

In the context of increasing globalisation and saturated domestic markets, young firms and SMEs are increasingly the target of mergers and acquisitions (M&As) by other companies, including for growth purposes, the broadening of a company’s product range or the strengthening of technological competencies (Hussinger, 2010). In the case of small family businesses, however, the sale to strategic investors may be resisted, including because of a fear of the loss of (local) jobs.

Initial Public Offerings (IPOs) (i.e. the issue of shares to raise capital from a wider group of investors) can be a transfer option, but it is rarely considered a feasible option for SMEs, and family businesses in particular, including businesses with high growth
potential, largely due to disclosure requirements and costs, but also for the dilution of ownership and the loss of managerial discretion that going public entails.

Transferring a business can be a complex task, which demands adequate planning and competencies. The complexity arises from the number of parties that are typically included in the process, often with differing expectations, the involvement of advisors and financial institutions, as well as the variety of regulations that apply, such as contract arrangements and tax law, including on gift and inheritance, and the incumbents’ pension schemes. In addition, the valuation of the enterprise typically represents a critical and complex stage in the transfer process.

The absence or delay in transfer planning further challenges the transferability of enterprises. The transfer process is in most cases a unique event in the transferors’ and transferees’ life, for which they have no or only little experience. Furthermore, owners of SMEs often begin to deal with their own withdrawal relatively late. For instance, a survey conducted by the Family Firm Institute in 2017 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. 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.

The takeover of established businesses often requires financial capital. Smaller businesses typically rely on personal resources from the owner (beyond the company’s equity) when a transfer or selling takes place. An additional financial weakening can occur when other family members need to be paid out (OECD, 2017). Approximately every second Canadian SME owner, for instance, ranks obtaining the necessary financing for a takeover among the top barriers of transfer planning (Canadian Federation of Independent Business, 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 addition, administrative obligations can pose a challenge. In some countries, businesses are legally required to inform employees of the transfer. In Germany, for instance, the business owner has to inform each employee in writing about the business transfer, including the exact timing of the (intended) transfer, the reason for transfer, legal, economic and social consequences for the employee, as well as the intended measures that may affect the employee (e.g., protection against unfair dismissal, further training measures that result from changes in production). In 2014, similar legislation was adopted in France.

To sum up, failures in business transfer are driven by a combination of factors. However, in the absence of current and representative statistical data on business transfers, 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.

What are key areas for policy to consider?

Many countries have recognised the importance of business transfers for SMEs and taken action to improve the conditions for business transfer. For instance, at the European level, in 1994, the European Commission issued Recommendations on the transfer of small and medium-sized enterprises. Business transfer issues are also specifically addressed by the

A variety of strategies and instruments are being developed 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. Key areas for policy makers to consider include:

- **Improving the evidence base:** 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. A better understanding is also needed of the implications of various tax issues for SME business transfer.

- **Increasing awareness of the importance and complexity of business transfer planning, including for expected and unexpected transfers:** 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. 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.

- **Increasing the number of (potential) transferees:** Raising awareness by potential new founders regarding the possible takeover of established companies, as well as promoting entrepreneurship among all segments of the population, including among disadvantaged groups such as women, youth, ethnic minorities or migrants, can contribute to addressing “transfer gaps”. 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.

- **Ensuring appropriate financing conditions:** 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, Finvera, 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 and, in Denmark, 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.** 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 (Box 2.1). 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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  **Box 1. 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** provides 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.

Further Reading


Ziniel, W., Gavac, K., Seidl, T., Bachinger, K., & Voithofer, P. (2014), Unternehmensübergaben und -nachfolgen in Österreich.