COMPARISON OF DIFFERENT POSSIBILITIES OF SUCCEEDING A FAMILY BUSINESS IN GERMANY

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Abstract
Handing over a business can be done in very different ways with different risks and opportunities, especially if it is a family business. This paper starts out by defining the terms family business and business succession. After the main topics have been defined, the differentiation of business succession by level of preparedness will be explained. This will be followed by taking a closer look at the different aspects of business succession. Which will be separated in a family internal and family external part. Also, the groups of people who can take over the business such as family internal succession, management buy-in, management and employer buy-out, buy-in MBO, owner buy-out or an institutional buy-out will be looked at and differentiated. The reader will receive a short overview about the definition, the differentiation and a conclusion in the end. The authors decide to give a brief overview about the different possibilities of handing over and which aspects are influencing the process of handing over.

Keywords: Business succeeding, SMEs, buy-out, family business.

JEL Classification: G23, D20, L20.

Introduction

Between 2014 and 2018 more than 135.000 German family businesses have to face the project of handing over the company. But only 12 % of these companies are able to succeed the business to the third generation and furthermore only 1% are able to hand over to the fifth generation (Knop, 2017). In this paper the different options of handing over a family business internally and externally will be explained to give the reader an overview of the different possibilities. In the beginning the terms family business and succession will be defined, followed by a description of reasons to transfer a company and how it can be classified. Later the different ways of transferring the company internally and externally will be explained in detail followed by the conclusion. The changes in the markets and the globalization make it necessary for organisations to check for the best options to keep the business running after the current managing director has left the business. A survey made by the “Deutsche Unternehmerbörse” in 2011 described, that only 57% of the current leaders see their own children as possible successors in the company, while 63% of the leaders stated that their children have other interests and do not want to succeed the family business (Deutsche Unternehmerbörse DUB.de GmbH). This development of the situation makes selling or leasing of a company more important. But for the 2.000.000 employees the handing over of the company to an external group of investors or managing director can cause fear, a lack of motivation and a high fluctuation. Therefore the internal transfer of the company to the current management or employees can also be an option.

1. Definition of family business

The definition of a family business is based on the relation of organisation and owner of the company (Hennerkes, 1999). Morris et al. (1997) defined in the journal of business venturing a family business as follows: "Family business is defined with family ownership and management involvement criteria. A company can be a family business and not fulfill the requirements of a small and medium sized enterprise. This can be seen by famous german companies like Miele. Miele has stated that in 2015 they had 17,741 employees, a turnover of 3.49 billion euro and a total equity of 930.08 million euro (Miele, 2015 and Hoovers.com, 2016). The family Miele is holding 51% of the shares and 49% the family Zinkann, which makes the company owned by two families (Miele, 2015). Denise Fletcher (2002) adds "[...] any company, irrespective of size, business operations and organisational structure, when owned or controlled by one family (or family units)[...]", that an organisation "[...] can be defined as a family enterprise when family members are predominantly involved in its operations, management and ownership regime, and thus can determine its destiny". In the example of Miele it depends on the point of view if the following design of leading management level is fulfilling the requirements of Ms. Fletcher or not.

2. Definition of business succession

The definition of a business succession by Beckhard and Dyer (1983) describes it as a passing of the leadership from the founder-owner to a family member or a non-family member as a successor (Beckhard, et al. 1983). The research of the IFM in Mannheim (2000) showed, that the number of family internal successions of a company is reducing due to the following reasons: the following generation is willing to make their own way of live and has no interest in the family business; a general reduction in sense of belonging and tradition; well educated family members are already in good and permanent employment; a reduced willingness to take the risk and responsibility of the following generation. Mentioned by Thomas Wetzel (2012), the chances of a successful handing over of a family business to the next generation are increasing if the involved parties are engaged with the topic a long time before the handing over. The succeeding of a business is not only a topic for the leader and the successor. Changing the leader of a company can simultaneously mean a change in the style of leadership and can cause turbulence and fear in the company. It influences the whole company and therefore can be handled with the tools of change management.

In the horizon scan, published in 2016 by the Business Continuity Institute it is clearly visible, that the loss of a key employee is in fourth place, which means that 59% of the interviewed organisations see it as a critical factor for the organization (figure no. 1). It could be interpreted that this also includes the managing director and therefore a planned handing over is more likely to achieve a higher success compared to an unplanned or an unexpected handing over.

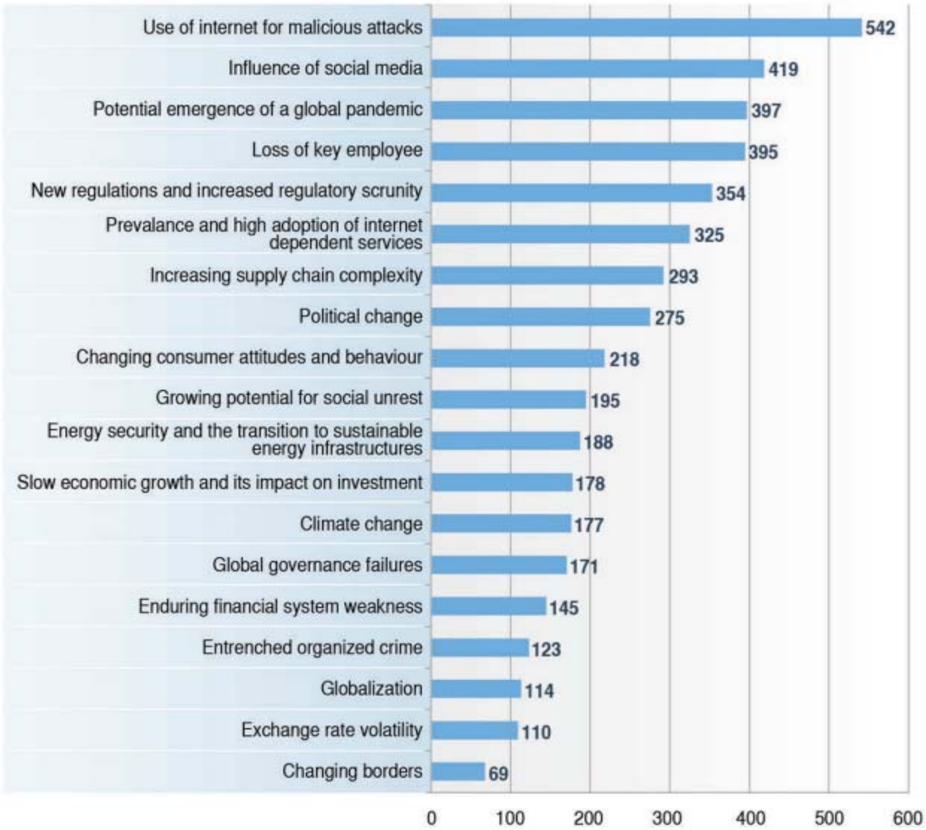

Figure no. 1: Trends to evaluate in terms of Business continuity implication
Source: Horizon Scan 2015, 2016 p.13

The statistics and analysing company Statista GmbH based in Hamburg has published in 2016 the statistic about the main inhibitions for entrepreneurs for handing over a business (figure no. 2).

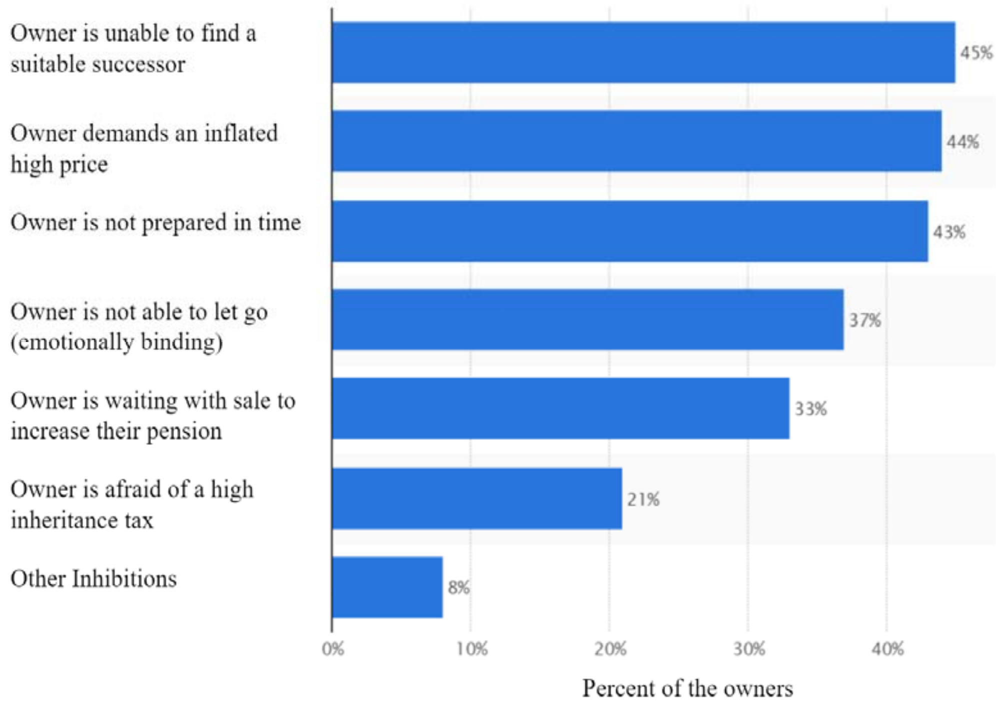

Figure no. 2: Inhibitions for entrepreneurs for handing over a business
Source: Statista 2016, n.d. *Hemmnisse für Inhaber bei der Unternehmensnachfolge, 2016*

The main problem is that the entrepreneurs are not able to find a suitable successor for the business. Directly followed with 1% less is the price which is esteemed as too high for the value the business is providing. In the third place and also with 1% behind the second place is that the entrepreneurs are not well prepared for the handing over. One big problem, which can often be seen at family owned business in which the entrepreneur is also the founder of the business is in fourth place, high emotional binding of the owner of the business and he is not able to let go.

3. Differentiation of a handing over by the level of preparedness

The German state Thüringen gave in their information document PDF of „Gründen und Wachsen in Thüringen" the definition of succeed a business of planned, not planned and unexpected as seen in the table no. 1.

Table no. 1: Differentiation of a handing over by the level of preparedness

Planned	Not planned	Unexpected
Long and medium term looking for a successor	Main reasons are divorces, disputes or other personal decisions	Main reasons are illness, accidents or death of the entrepreneur
Fixed date for the handing over	No clear regulations for the handing over	A solution for the succession has to be found in a short period of time
Clear documented regulations for the succession	Only a short period of time is available	A limited amount of time is available
The handing over is communicated		

Source: Anon, 2012. Leitfaden Unternehmensnachfolge. 1st ed. [ebook] Erfurt: Industrie- und Handelskammer Südthüringen, p.3

It can be stated, that in a planned situation the organisation has time to implement long and medium term targets, document and plan the handing over, integrate the new successor and communicate the new situation to the employees, customers and suppliers. This is the best foundation for a successful handing over of the company and should be aimed at. In the second case the organisation has some time to counteract the unplanned situation, but there are also some uncertainties which can damage the company and can cause fear in the employees because they do not know how it will go on in the future. A business continuity management system can help to look at such a point in advance to define what will be the actions in a pre-defined case. In the last situation the organization only has a limited period of time, because the founder has died, is ill or has an accident and is unable to lead the organisation any longer. This is what the business continuity management system is developed for to have a plan in the desk which can be used to handle such a situation until a new leader has been implemented.

4. Different options of succeeding

By expanding the definitions of Birgit Felden and Armin Pfannenschwarz (2008) the family internal succession and the family external succession with its different ways of cooperation with external organizations and employees will be explained in detail:

- ***Family internal succession***

The traditional way of succeeding a family business is the handing over of a business to a family member. For example to a daughter or a son. Michael Grote the CEO of the Deutsche Unternehmerbörse said (Deutsche Unternehmerbörse DUB.de GmbH): *"The current generation has much more opportunities for their development than they had ten or twenty years ago. …"*

Therefore the number of handings over to the next generation will reduce in the next years, due to a lack of willing successors. In 2011 a family internal succession was planned for

79% of the interviewed companies, on the other hand only 44% regard a handing over to a family member as successful, which means that 13% of the companies have planned to hand over the business to a family member but are sceptical about the future (Deutsche Unternehmerbörse DUB.de GmbH). A current leader should also consider, that a family member, like a daughter or a son, will experience a high pressure to take over a company and does not have the necessary skills to take over the business (Brandenburg, 2012). In 2013 the IFM in Bonn published their results of a meta analysis which showed that 54% of the family businesses are handed over to another family member. But also Michael Grote stated during an interview with the Handelsblatt in 2012:*"A family internal handing over of a company is mostly a simple and the easiest solution. But later this succession of a business turn out to be bad prepared, rushed and simply the wrong decision."*
This should also be taken into account when handing over a company.

- ***Family external succession***

There are plenty of options for a family external succession of a company, for example the Management buy-in scenario, in which the business is sold to an external manager or a group of managers who are taking over the ownership and the leading of the company. In 2016 34 management buy-outs in germany (between 50 and 250 million euro) have been financed by private equity companies with a total amount of 3.6 billion euro, a growth of 0.9 billion compared to 2015 (Deutsche Beteiligungs AG, 2017). By taking into account, as the IFM in Bonn stated, that between 2014 and 2018 135,000 companies have to be handed over the part of management buy-out, financed by private equity is rather the exception (Kay and Suprinovič, 2017). The advantage is, that the new managers bring in new ideas and are able to optimize the structure of the organisation and can save the workplace (Wink, 2014). The negative aspect is, that the new management has to learn the roots of the new organisation, is not familiar with the structure and can have failed estimations of the earnings (Kneer, 2009). The IFM stated in 2013 that 29% of the businesses which had been handed over are succeeded by an external person or group. This could be a single CEO or a group of people (Kay and Suprinovič, 2013). The Management and Employer buy-out describes that the business is taken-over by internal employed persons who are taking over the owner- and leadership of the company. This could be a smaller group like a management buy-out in which the current management takes over the business or a bigger group like employees, which could be a negative aspect because of the bigger amount of shareholders. This is a way of handing over the business with which at least 17% of owners decide to go by. (Kay and Suprinovič, 2017) The combination of a buy-in and buy-out is named Buy-in MBO. In this case the existing management buys out and a group of external investors is also taking a seat in the management of the company. The buy-in management buy-out is trying to combine the advantages of the management buy-in and the management buy-out and avoid the disadvantages. Kneer (2009) mentioned that it can be a problem to remove the external manager if something does not go as planned on one hand, but on the other this hybrid version is more and more prefered instead of the Management buy-in, which has a high error rate. The Owner buy-out describes the funding of a new company which has the main purpose to hold shares of the old organisation, which is often used for a business succession (Wink, 2014). This new company, so called "newco", will be used to reorganise the property reservations for example external investors or family successors (Neukirchen, 1995). One advantage is the reduced tax burden during the family internal transfer of the company (Neukirchen, 1995) and the spreading of the risk (Wink, 2014). The last to be mentioned models of handing over a company in this paper is the

Institutional buy-out. This model uses external investors who are buying shares of the company and the management can stay (Sauermann, 2010) or can be replaced (Pacher, 2011). The external investors, which can be for example a private equity group have the main role in the lining up of the company and its strategic targets (Krämer, 2007). Target of a private equity group is to invest in companies which are not listed at the stock market to strengthen the organisation and then exit the company in different ways to gain profit (Meurer, 2007).
Birgit Felden and Armin Pfannenschwarz (2008) separates the different options of succession in a matrix which describes the traditional way of handing over a company. A family member takes over ownership and leadership. The mixed managing directorship can be a situation in which an external leads the company in cooperation with a family member while the company is owned by the family. Compared to the third situation in which the family owns the company, but an external takes over the leadership. This can be the situation in which none family member is able or willing to lead the company due to a lack of knowledge, other interest or the low age of children. In the first case of the mixed ownership situation the family leads the organisation and owns a part of the company while for example a venture capital provider also holds shares of the business. In the second situation the ownership situation is still splitted, but the external party is also active in leading the organisation. In the last situation the family still owns parts of the organisation but does not lead the organisation anymore. In these cases, the company is fully owned by an external party. It is therefore not very common that family members are still involved in the leading of the organisation. The most realistic way is, that the whole organisation is sold to a family external group which will also take over leadership of the company, which can be for example a strategic of financial investor, which has been handled above.

Table no. 2: Differentiation by type of leading and owning

Leadership by **Ownership by**	**Familymember**	**Mixed form**	**External**
Familymember	Traditional family member will succeed the business	Mixed managing directorship	non-family Member take over Lease of the business
Mixed form	Integration of a Partner, Venture capital providers, associated company	Integration of an active partner	E.g. the creation of a Foundation
External	Marginal Case: Further employment of family members after the handing over of the company to a third party		Sale of the business to a strategic or financial investor

Source: Felden, B., Pfannenschwarz, A., Grosser, A., Meissner, D. and Assaf, H., 2008. Unternehmensnachfolge. Oldenbourg: Oldenbourg Verlag, p.27

Conclusions

Business succession is a complex topic and there are many variables which are influencing the process. Handing over a family business is more complex due to the involvement of the family which has to be taken into account. The different stakeholder increases the complexity of the process due to their significance to the company. On one hand there is the owning family, who is maybe also involved in management decisions and can have a high emotional binding to the business. The current CEO has maybe founded the company or led it over a long time. He invested a lot of money, time and effort which can cause also a big personal binding. He is highly involved in the process of succeeding the business and if it is a family internal succession is maybe facing the problem of who will take over. If there are many candidates it is on him to decide to split the led or maybe choose one. People are always afraid of change and business succession is always coming with changes. This can cause fear within the employees due to the unexpected outcome of the handing over. The options how to proceed the business successions have been explained during the paper and it is possible to separate them in family internal and family external. In general it can be stated, that a successfully done family internal business succession needs to be prepared and needs to be planned over years. Finding the right track is not only based on the decision to whom the company will be handed over in which way but also on the available time of preparation and the differentiation about current and future owning and involvement of the family. Sometimes a family internal handing over is not done due to the personal interest of the daughter or son to follow a different path and not willing to take over the business. On the other hand sometimes the family members are too young or do not have the right skills for leading a business. In these cases handing over to a family external party could be an alternative for secure the jobs and the organization. The process is complex and there is not the “one way” of doing it best. But taking into account the different options and assess the advantages and disadvantages of each way will help to get an overview about the possibilities.

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