Entrepreneurship in the Netherlands

Business transfer: a new start

Colophon

This publication forms part of a series relating to entrepreneurship and small businesses.

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Preface

Entrepreneurship is a spearhead of Economic Affairs Policy. During the last few years in particular, entrepreneurship has grown in importance for the Dutch economy. In times of economic recession, the dynamics, employment and competition related to entrepreneurship are vital.

In my policy letter *In Actie voor Ondernemers* [In Action for Entrepreneurs] (2003) I laid out my efforts to increase the number and raise the standard of entrepreneurs. I proposed 43 actions to improve the entrepreneurial climate throughout the lifecycle of a company: from start-up and growth to the transfer of business ownership or closure. A large proportion of these actions have since been implemented.

The 8th edition of *Entrepreneurship in the Netherlands* is devoted to the transfer of business ownership. This is because the transfer of business ownership is a crucial phase in the lifecycle of a company. It means a farewell for the leaving entrepreneur, but also a fresh start for the party taking over. Successful business transfers often lead to innovation and growth in productivity.

The importance of successful transfers will increase over the coming years. Our population is ageing, and so are our entrepreneurs. For the next ten years, around 18,000 businesses per year are expected to transfer ownership in the Netherlands.

Transfers of business ownership do not automatically run smoothly. The transfer process is characterised by various pressure points, such as a lack of planning, difficulty finding a successor and financing problems.

I want to pave the way for successful transfers. I have already taken various steps towards achieving this objective, such as loosening the tax demands during transfers through gift or inheritance and introducing a large-scale campaign to make entrepreneurs aware to start preparing the transfer in time.

In order to give you an insight into the issues surrounding transfers of business ownership, this edition presents the importance of a policy on the transfer of business ownership in the Netherlands. In addition, Professor Morris from Syracuse University gives an American view on the policy regarding the transfer of business ownership.

I hope you will enjoy reading!

Karien van Gennip
State Secretary for Economic Affairs

1 Introduction by the editors

This report is the eighth edition of the series "Entrepreneurship in the Netherlands". As demonstrated by the name of the series, the reports focus on entrepreneurship but each year a different aspect of entrepreneurship is studied. Previous issues that have been reviewed include entrepreneurship and competitiveness, ambitious entrepreneurs, nascent entrepreneurs, entrepreneurship in the new economy and innovative entrepreneurship.

This eight report deals with business transfer. In the coming years many entrepreneurs in the Netherlands as well as in Europe will retire and cease trading. This will create a large number of enterprises that will be for sale. However at this stage the market for buying and selling such businesses, at least in the Netherlands, is not very well developed and there is a risk that successful enterprises will be closed unnecessarily. In the framework of their entrepreneurship policy, governments as well as the European Commission have developed actions to stimulate a smooth acquisition of these enterprises.
In this report, the business transfer case in the Netherlands and the policy developed by the Dutch Government are described. The editors have asked Michael H. Morris to provide his vision on the subject. Michael Morris, Witting Chair in Entrepreneurship, Chairman Dept. Entrepreneurship Emerging Enterprises, Syracuse University, New York, USA.

Structure of the report
As in previous editions, the report starts by providing some key data on the development of entrepreneurship and entrepreneurial spirit in the Netherlands. To assess the Dutch situation, these data are benchmarked against other EU Member States and the United States.
In Chapter 3 "Business Transfer in the Netherlands" Joris Meijaard of EIM presents the most recent data on business transfer in the Netherlands and the factors that have an effect on the success of a business transfer.
Chapter 4 "Business Transfer: A Policy Perspective" is prepared by Yvonne Haane of the Ministry of Economic Affairs. In that chapter, she describes the policy of the Dutch Ministry to improve the investment climate for business transfers.
Finally, Michael Morris describes the extent to which a government policy regarding business transfer is needed, how the quantity and quality of successful transfers can be influenced, and gives suggestions on how policy makers should approach the transfer issue in their country (see Chapter 5).

The editors thank all the authors for their participation in this project.

Yvonne Haane, Ministry of Economic Affairs
Jacqueline Snijders, EIM Business & Policy Research

2 *Entrepreneurship in an international context*

by Jacqueline Snijders, EIM Business & Policy Research, the Netherlands

New and small enterprises are the backbone of an economy; they are a key source of jobs and a breeding ground for business ideas. They are considered as main drivers of innovation and employment as well as social and local integration.
As mentioned in the preface by Karien van Gennip and the policy paper "In Action for Entrepreneurs", the Dutch entrepreneurship policy is aimed at stimulating entrepreneurship through the life cycle of the enterprise, so that the number of entrepreneurs can increase and existing enterprises can grow and flourish. In addition, the attractiveness of being an entrepreneur should be improved.
One of the objectives of the entrepreneurship policy is to smooth business transfers. Due to the baby boom after the Second World War the number of entrepreneurs that are planning to retire is large and consequently a relatively large number of enterprises are or will come up for sale. It is obvious that stimulation of entrepreneurship should not include only the start up of completely new enterprises. People who want to start up their own enterprise can also consider the acquisition of an existing enterprise.
More information on business transfer and the policy developed can be found in the other contributions to this report.
In this chapter, we present some key figures on the development of entrepreneurship and entrepreneurial spirit in the Netherlands, a number of other EU countries and the USA and Japan. This information should be considered as background information for understanding and comparing the other contributions to the report. One may expect that an entrepreneurial society will have a positive effect on the business transfer process.

2.1 Entrepreneurial climate in an international context

The entrepreneurial climate of a country and its development can best be described on the basis of 3 indicators:

- The number of entrepreneurs in the working populations;
- Birth and death rates; the number of entries and number of exits as percentage of the total number of enterprises, and finally
- What can be called the entrepreneurial spirit or the Total Entrepreneurial Activity Index (TEA); the number of persons that are active in setting up an enterprise or who own a recently set up enterprise.

Number of entrepreneurs in the working populations

In 2003, 10.8% of the Dutch working population were entrepreneurs and as Table 2.1 shows this is in line with the EU average (11.3%). The percentage is much higher in for example Italy, and much lower in Denmark. This is, among other things, related to average enterprise size. In Italy for example, the average size of an enterprise is 4 people employed, whereas the size in Denmark is 10. The average size in the Netherlands is 12 people employed[1].

As in the other EU countries, the percentage of entrepreneurs was quite stable in the period 2000-2003 (see Table 2.1).

Table 2.1 Percentage of entrepreneurs in the working population (private sector excluding agriculture and fisheries)

	2000	2002	2003
Belgium	11.7	11.6	11.5
Denmark	6.1	6.7	6.5
Finland	8.1	7.9	8.1
France	8.3	8.1	8.2
Germany	8.7	8.6	8.8
Ireland	11.3	11.2	11.2
Italy	18.5	18.3	18.3
Netherlands	10.9	10.8	10.8
United Kingdom	10.5	10.7	11.3
EU-15	11.2	11.2	11.3
United States	9.8	9.5	10.4
Japan	9.7	9.2	9.1

Note: Data for 2001 are not available.
Source: EIM, Internationale Benchmark Ondernemerschap (International Benchmark Entrepreneurship) 2004, Zoetermeer 2005.

2.2 Birth and death rates

Birth rates

The birth rate is defined as the number of entries (start-ups and new affiliates) as percentage of the total number of enterprises. In 2003, the birth rate in the Netherlands was slightly higher than in most other EU-countries. Only Germany and the United Kingdom have higher birth rates. In 2002, Ireland, the USA and Denmark also performed better.

In the period 2000-2003, birth rates in the Netherlands were reduced, from 11.1 to 8.0%. This negative trend was also visible in Ireland. In the majority of other countries this development has been more stable.
In 2002 and 2003 birth rates in the Netherlands remained more or less the same. This can be explained by the low economic development that lasts longer than in the other EU countries. There are however indications that the birth rate in the Netherlands has increased again in 2004.

Table 2.2 Birth rates

	2000	2001	2002	2003
Belgium	6.5	6.3	6.2	6.0
Denmark	11.7	10.1	9.9	-
Germany	9.9	9.2	8.9	10.0
Finland	8.2	7.9	7.9	8.4
France	6.9	6.8	6.7	7.5
Ireland	15.1	12.6	11.9	-
Italy	7.7	7.9	7.7	7.2
Japan	-	4.1	4.0	-
Netherlands	11.1	9.7	8.1	8.0
United Kingdom	13.3	12.7	12.6	13.2
United States	10.1	9.5	9.6	-

Source: EIM, Internationale Benchmark Ondernemerschap (International Benchmark Entrepreneurship) 2004, Zoetermeer 2005.

Death rates

The death rate is defined as the number of exits (bankruptcies and other closures) as percentage of the total number of enterprises. In 2003, the death rate in the Netherlands was 6.6%. Compared to other countries, this rate is still relatively low; only France, Japan and Italy have a lower share of exits. These countries are however characterised by a lower share of entries and in general there is a strong relationship between the number of entries and the number of exists.

In the period 2000-2003, death rates in the Netherlands have increased slightly. Since 2000, the absolute number of bankruptcies in the Netherlands is increasing, but compared to most other countries the percentage of bankruptcies is still relatively low. This means that the majority of enterprises are closed for other reasons.

Table 2.3 Death rates

	2000	2001	2002	2003
Belgium	6.6	6.3	6.0	6.6
Denmark	9.5	10.1	9.9	-
Germany	7.3	7.0	7.0	7.1
Finland	7.6	7.7	7.3	7.4
France	5.5	4.3	4.1	-
Ireland	5.7	7.6	7.4	-
Italy	5.4	5.5	5.9	6.0
Japan	-	4.5	4.6	-
Netherlands	6.1	6.3	6.6	6.6
United Kingdom	11.6	10.7	10.4	11.2
United States	8.9	9.2	8.9	-

Source: EIM, Internationale Benchmark Ondernemerschap (International Benchmark Entrepreneurship) 2004, Zoetermeer 2005.

Net effect birth and death

Due to births and deaths, the number of enterprises in the Netherlands has increased in 2003 by 1.5%. This increase was the same as in 2002, but lower than the years before. A similar trend is visible in Denmark and Italy. Compared with the other EU-countries, the net growth in the Netherlands is still rather low.

Table 2.4 Net growth of number of enterprises as percentage of total number of enterprises

	2000	2001	2002	2003
Belgium	-0.1	-0.1	0.2	-0.3
Denmark	2.2	0.0	0.0	-
Germany	2.6	2.2	2.0	2.9
Finland	0.6	0.2	0.7	1.0
France	1.4	2.5	2.6	-
Ireland	9.3	5.1	4.6	-
Italy	2.3	2.4	1.9	1.2
Japan	-	-0.4	-0.6	-
Netherlands	5.0	3.4	1.5	1.5
United Kingdom	0.2	0.7	1.6	0.5
United States	1.1	0.2	0.3	-

Source: EIM, Internationale Benchmark Ondernemerschap (International Benchmark Entrepreneurship) 2004, Zoetermeer 2005.

2.3 Total entrepreneurial activity

To measure the entrepreneurial activity of a country, the Total early-stage Entrepreneurial Activity (TEA) index can be used. This index, developed within the Global Entrepreneurship Monitor (GEM) , is essentially the sum of nascent entrepreneurs (people that are currently involved in concrete activities to start up a new business) and owners of young businesses (people currently owning a business that is less than 42 months old).

Five percent of the Dutch adult population are entrepreneurially active

In 2004, the level of entrepreneurial activity in the Netherlands was 5.1 and it was the first time since 2001, that this percentage increased (see Table 2.5). This positive development is mainly the consequence of the increase in the share of nascent entrepreneurs. The rate of nascent entrepreneurs rose from 1.7 in 2003 to 3.0 in 2004.

Table 2.5 Development of the Total early-stage Entrepreneurial Activity (TEA) index the Netherlands and the European Union (EU), 2001-2004

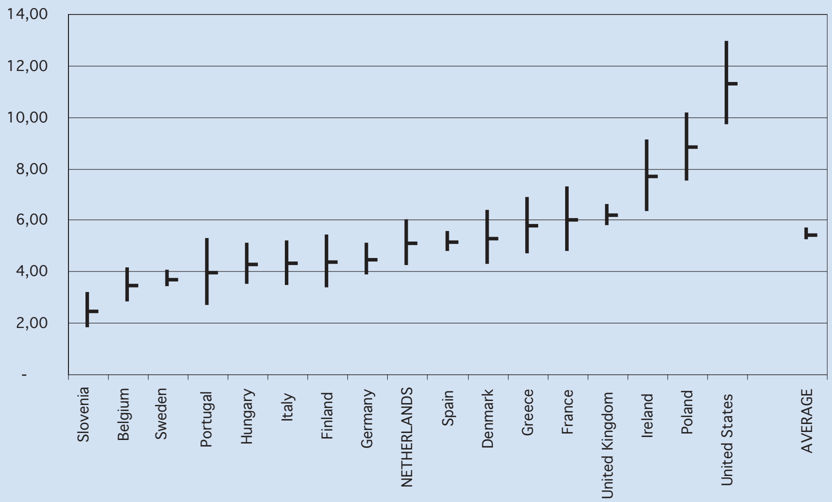
Year	Netherlands	EU
2001	6.4	7.9
2002	4.6	5.1
2003	3.6	5.1
2004	5.1	5.1

Source: EIM/GEM.

Early-stage entrepreneurship in the Netherlands now at EU-average

The average TEA index for the EU Member States is 5.1. The Netherlands now takes a position in the middle of the Union; both the share of nascent entrepreneurs and the share of owners of young businesses are at EU-average (see Figure 2.1). However, the TEA index in the United States is much higher than in the Netherlands: 11.3.

Figure 2.1 Total early-stage Entrepreneurial Activity (TEA) indices per country. EU-countries participating in GEM, 2004



Note: TEA is defined as the number of nascent entrepreneurs and owners of young businesses per 100 individuals in the 18-64 adult population.

Source: EIM/GEM. The vertical bars represent the 95 percent confidence interval.

Attitudes to and perceptions of entrepreneurship provide a good base

The GEM also shows that in the Netherlands a comparatively large number of people positively appreciate the move to set up a new enterprise. From a European perspective, the Netherlands scores highest.

The opportunities to set up a new enterprise are regarded more positive in 2004 than in 2003. In addition the number of persons that intended to start their own enterprise has increased. The number of Dutch people that state that fear of failure would prevent them from setting up a new business has gradually increased since 2001, but it continues to be lower than the average for the EU-countries.

37% of the Dutch adult population are potential entrepreneurs

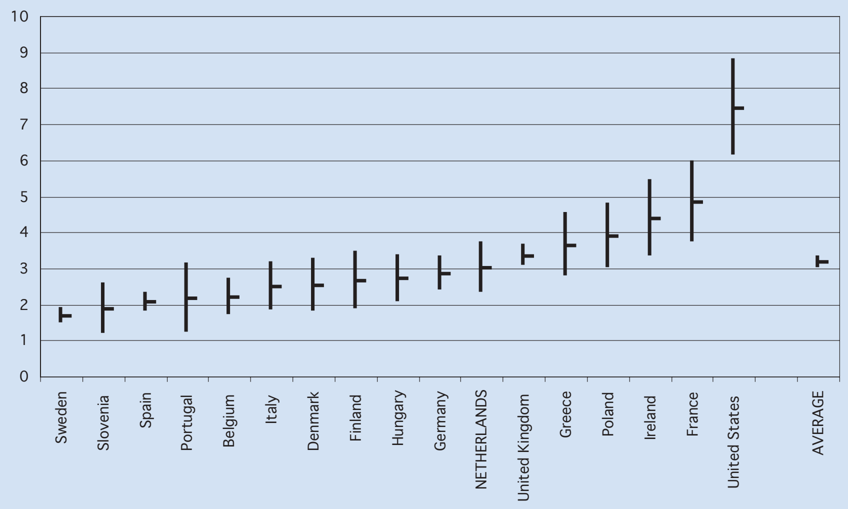
GEM reveals that more than one third of the Dutch adult population think they have the knowledge and skills to start-up a business. As described above, these persons are called 'potential entrepreneurs'. This share has increased since 2003 (32%), but it is still below the European average (41%).

Three percent of the adult population are nascent entrepreneurs

In 2004, 3% of the adult population were in the process of setting up an enterprise, alone or with others. This is almost the same as the European average (see Figure 2.2).

In France (4.9%) and Ireland (4.4%) for example, the level is higher than in the Netherlands. The percentage for the USA is 7.5%.

Figure 2.2 'Nascent' entrepreneurs EU, 2004, in percentages



Source: EIM/GEM (2004). The vertical bars represent the 95 percent confidence factor.

2.4 Summary and conclusions

In this chapter, we have focussed on the entrepreneurial activity and entrepreneurial spirit in the Netherlands, in other EU countries and in the US.

The Netherlands

In the period 2000-2003, the share of entrepreneurs in the Dutch working population has remained the same (almost 11%), but there are indications that the share is increasing in 2004. During the period 2000-2002, the percentage of new entries (birth rate) in the total business sector has decreased and in 2002 and 2003 the level remained more or less the same. This is related to the low economic development that lasts longer in the Netherlands than in the other EU countries.

The percentage of exits has increased in the period 2000-2001, but remained stable in 2002 and 2003. In total, the number of enterprises has increased by 1.5% in 2002 and 2003.

These developments are also reflected partly in the early-stage Entrepreneurial Activity index (TEA). The TEA has also decreased in the period 2001-2003 from 6.4 to 3.6, but increased in 2004 to 5.1. The latter is mainly the result of an increase in the number of nascent businesses. This may indicate that the entrepreneurial spirit is improving.

The Netherlands in an international context

The share of the entrepreneurs in the working population is higher in Belgium and Italy and lower in Denmark, Finland, France and Germany. In all countries the development is stable. Birth rates are higher in the UK, Ireland, Denmark and the USA and lower in Belgium and France. Higher birth rates generally lead to higher death rates. Consequently, death rates are higher in Denmark, Germany, Finland, Ireland, the UK and the USA.

In the period 2000-2003, the birth rate in the Netherlands has decreased, whereas in the majority of other countries this development has been more stable. The death rate has increased slightly whereas it has decreased in some other countries. The number of

bankruptcies in the Netherlands has been relatively low and has reduced slightly.
In total, the net growth of the total number of enterprises in the Netherlands has decreased in the period 2000-2003, but in 2003 the net growth remained the same as in 2002.

Entrepreneurial spirit

In line with the TEA index, the appreciation of entrepreneurship in the Netherlands has improved. Compared to other EU countries, a large number of people positively appreciate the move to set up a new enterprise.
The opportunities to set up a new enterprise are also regarded as more positive in 2004 compared to 2003 and the number of persons that are considering starting an enterprise has increased. One third of the Dutch adult population think they have the knowledge and skills to start-up a business.

In the next chapters of the report we focus on a specific aspect of entrepreneurship, viz. business transfer. As mentioned in this chapter, the largest share of exits consists of closures and not bankruptcies. Probably a number of these enterprises could have been transferred instead of closed.

Notes Chapter 2

1 Much quantitative and qualitative information about SMEs in Europe can be found in the Observatory of European SMEs, a research project carried out by EIM Business & Policy Research for the Enterprise and Industry DG of the European Commission in the period 1992-2004. All reports (in English, French and German) can be downloaded from: http://europa.eu.int/comm/enterprise/enterprise_policy/analysis/observatory_en.htm. This link gives also access to databases of SMEs in Europe and the Member States.

3 Business transfer in the Netherlands

By: Joris Meijaard, EIM Business & Policy Research, the Netherlands

3.1 Introduction

The first impression one has of entrepreneurship is that of the daring individual that starts a new firm. Entrepreneurship is however much broader than that. Entrepreneurship can take many forms and may flourish under many different conditions. The success of entrepreneurial activities depends on personality traits and the personal endowments of the entrepreneur. It also depends on the human and social capital of the employees of the firm and on the competitive conditions of the respective business. Entrepreneurship as such is about managing a firm, about innovation, about finding new markets, about learning and about taking financial risks. Along these lines, entrepreneurship clearly also requires (1) looking for opportunities to change an existing firm, (2) devising and evaluating ways to act on such opportunities for innovation and change, and thus (3) trying to turn such opportunities into a success.

Thus, one of the relevant contexts of entrepreneurship is that of business transfer. Business transfer concerns the gradual or immediate transfer of leadership and ownership of an existing firm. The economic entity ("the business") survives, but under new management and under new ownership. After start-up, early survival and years of growth and possible decline, it is another key transition phase in the life of a firm. It is a phase in which strategy and structure are reconsidered, and that requires considerable 'entrepreneurial effort'. There are various types of business transfers. They can take place within the family, but also to an employee or to a third party[1].

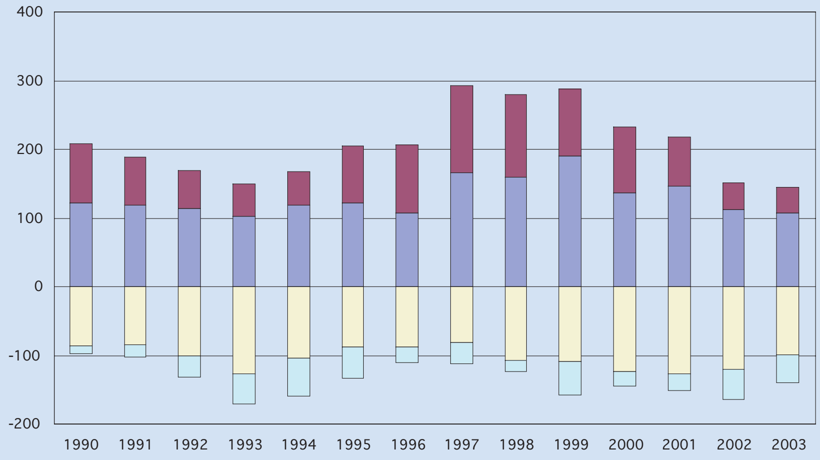
In this chapter, we begin by highlighting the current state of business transfers in the Netherlands. We then discuss the three main types of business transfer. After a general overview of determinants of business transfer success, we discuss how innovation and growth are critical to many business transfers. Overall we conclude that from both micro and macro perspectives, business transfers are important. Business transfers constitute a defining component of business dynamics and deserve serious attention.

3.2 Economic relevance of business transfers in the Netherlands

In this section, we illustrate the relevance of business transfers in the Dutch economy. Based on results, the direct effects of business transfer at firm level demand close attention in respect of both growth and innovation policy, as will be seen later.

The beginning of the 21st century has been a turbulent time for the Dutch economy. The years 2002-2004 have shown a stagnant, even recessive economy. Even by European standards, the Dutch economy has been performing poorly. To illustrate this, Figure 3.1 below depicts the overall dynamics of employment in incumbent Dutch firms. Clearly, 1993 and 2002-2003 were substantial dips in the business cycle. In 2002-2003, the number of job creations was as low as the early 1990s.

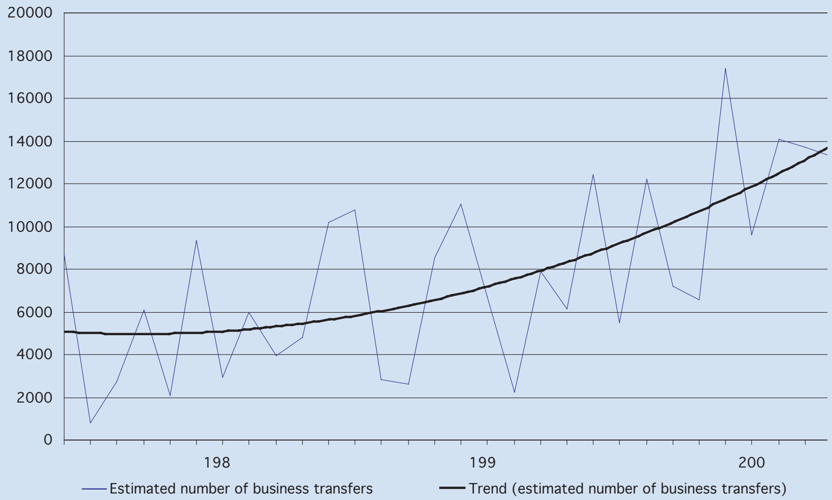
Figure 3.1 Employment growth and decline of incumbent SMEs and large enterprises in the Netherlands, 1990-2003 (x 1,000)



Source: *EIM, 2005, based on Chambers of Commerce and Statistics Netherlands (Gibcus and Verhoeven, 2005, Monitor Ondernemerslandschap - editie voorjaar 2005, EIM: Zoetermeer).*

Over these years, the number of business transfers was steadily rising. Figure 3.2 illustrates this. From year to year there is quite some variation. This is due to economic conditions, due to random fluctuations, and due to measurement errors in the estimates. Transfers recorded by the Chambers of Commerce (only about 60% of all transfers) do show comparable fluctuations.

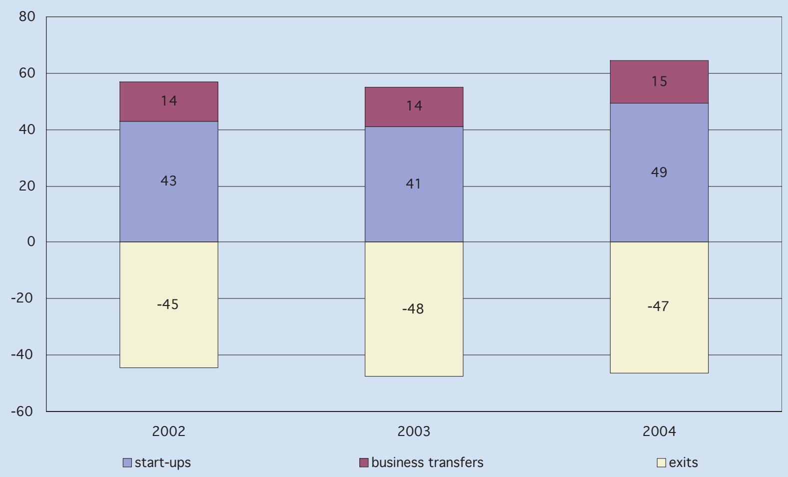
Figure 3.2 Estimated pattern of SME business transfers in the Netherlands



Source: *EIM, 2004.*

The annual number of business transfers is relatively small compared to the numbers of exits or start-ups (see Figure 3.3). It should be noted that the number of exits is an indication of the pool of potential firms for which a business transfer might have worked, but for which it did not take place. Fifty percent of all exits are young firms that have existed less than 4 years[2]. For most of these firms, a business transfer is less relevant, since typically only limited assets were accumulated. For all exits, the average number of jobs is three. For these young firm exits the average number of jobs is less than two. About forty percent of all firm exits are older than six years. Broadly speaking, a large part of this latter group of firms might have been a reasonable target for a business transfer.

Figure 3.3 Business population mutations in the Netherlands 2002-2004, in numbers of start-ups, business transfers and exits (x 1,000)



Source: EIM, 2005, based on data from the Dutch Chambers of Commerce.

Contrary to these numbers business transfers are relatively important, in terms of employment, particularly compared to start-ups. This is shown in Figure 3.4.

The fact that the transferred firms actually continued in business meant, on average, three times as much to overall employment than the direct employment effects of start-ups. It should be noted that the number of jobs lost due to business exits was more substantial than the number of direct jobs gained due to start-ups and almost as large as the number of jobs 'saved' by successful business transfers (see Figure 3.4). There seems to be room for efficiency improvements in business dynamics by reducing the number of business exits and increasing the number of business transfers. It should also be noted that the number of business transfers has not been rising in the last few years. As indicated above this may be an indication of a growing problem, given the aging population of entrepreneurs. A peak in business transfer activity may be expected after 2010 due to the 1945-1950 babyboom.

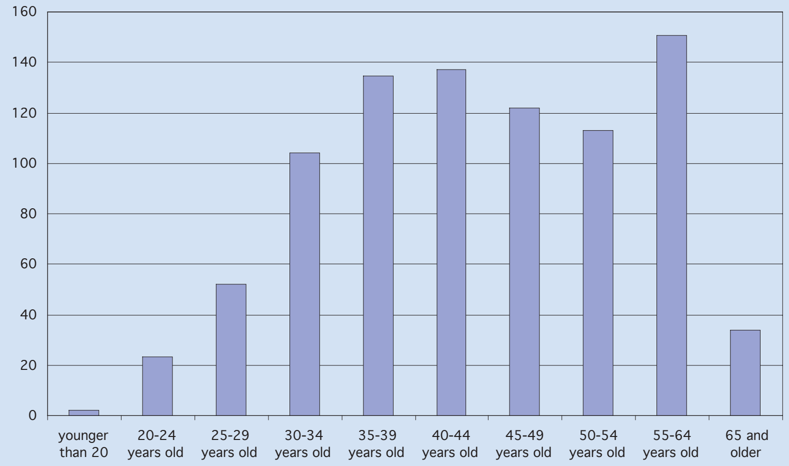
Figure 3.4 Direct employment effects in the Netherlands, 2002-2004, in number of FTE due to new independent start-ups, business transfers and exits (x 1,000)

Source: EIM, 2005, based on data from the Dutch Chambers of Commerce.

Examining Figure 3.4 and referring back to Figure 3.1, it is clear that business transfers are a substantial part of economic dynamics. Attention to business transfer in growth policy seems deserved in this respect.
Furthermore, we should note that the population of entrepreneurs in the Netherlands is ageing.

A substantial part of entrepreneurial population is older than 55 years. Figure 3.5 shows that this share is twentyone percent. For entrepreneurs over 55, business transfer is an important consideration. In the years 2002-2004, the share of older entrepreneurs in the total occurring number of business transfers was stable at fifteen percent. In these same years, the share of older entrepreneurs in the total number of exits (business closures) was nineteen percent. Essentially, this means that older entrepreneurs are relatively reluctant to transfer their businesses.

Figure 3.5 Age distribution of entrepreneurs in the Netherlands, 2004, number of entrepreneurs (x 1,000)



Source: EIM, based on data from the Dutch Chambers of Commerce, 2004.

In this section, we have illustrated the relevance of business transfers in the Dutch economy. Business transfers are an important and relevant dimension of business dynamics in the Netherlands. Below, we highlight which factors determine the success of business transfers at the micro level. Some of these factors differ between types of business transfer.

3.3 Various types of business transfer[3]

There are, essentially, three types of business transfers. These types determine the conditions for the transfer process and the conditions for the further development of the business.

Family transfers

Firstly, we may distinguish family business transfers. Ownership and leadership are transferred to one or more relatives of the current owner. Typically this means the firm is transferred to an insider of the firm: a successor who knows a lot about the ins and outs of the company, who knows and respects the business culture. At the same time, this also means that the successor is quite likely to be rather reluctant to make substantial changes.

Over the past fifteen years, two in five completed SME business transfers in the Netherlands have been family transfers. About three quarters of family transfers are from parent to child. Relative to the other types of transfers, new entrepreneurs of family firms are less educated. Only one third has a bachelor or master degree. Family successors are also relatively inexperienced. Two-third of them has ten or less years of professional experience.
In the transition, fifty percent of family transfers are 'very easy' according to both the predecessors and the successors.

Buy-out

Secondly, we distinguish management buy-outs. In such business transfers, ownership and leadership are transferred to members of current management and/or to one or more of the current employees. This means that the firm is transferred to an insider of the firm. The successor knows the ins and outs of the company and is likely to be reluctant to make substantial changes.

Over the past fifteen years, one in five completed SME business transfers in the Netherlands has been a management buy-out. The new entrepreneurs of management buy-outs are highly educated. More than half have at least a bachelor degree. Only thirteen percent of the management buy-out entrepreneurs have less than ten years of experience. In management buy-outs, similar to family transfers, the transfer process is quite easy according to both predecessors and successors (eighty percent of all cases). However, not many predecessors, only twenty percent, judge the process to be very easy. This share is much larger in family transfers.

Buy-in

Thirdly, we distinguish management buy-ins. In management buy-ins, the ownership and leadership are transferred to one or more external successors. These outsiders will take over the business. This means that there might be more problems in the transfer of relevant information about the firm. On the other hand, the advantage is that such a management buy-in will be far less reluctant to change the course of the firm.

Over the past fifteen years, one in four SME business transfers in the Netherlands was a management buy-in. The new entrepreneurs of management buy-ins are quite well educated (forty-five percent have at least a bachelor degree). About a quarter of management buy-in entrepreneurs have professional experience of less than ten years. In only ten percent of the management buy-ins a written business plan was made (as opposed to twenty percent for the other two types of transfers). Typically, many management buy-ins occur when all other solutions fail. As a result, forty percent of the predecessors judge the transfer process as difficult and laborious (as opposed to ten percent in family transfers and twenty percent in management buy-outs).

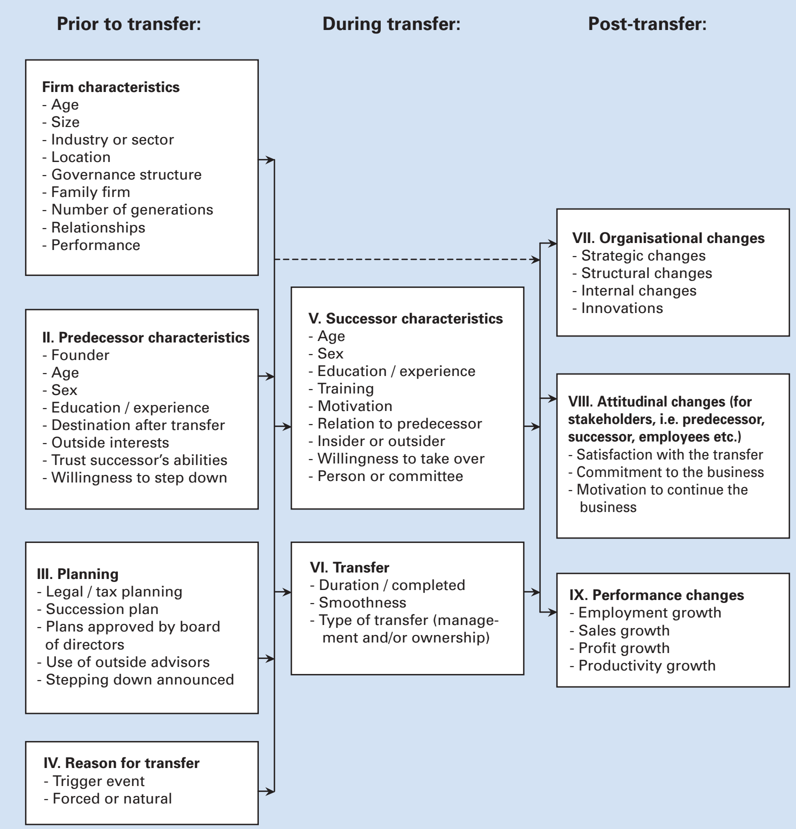
3.4 Determinants of the post-transfer situation

A range of factors may determine the post-transfer features and performance of a business transfer. Figure 3.6 depicts the most important features prior to the transfer and during the transfer process that determine the post-transfer situation. It provides an overview of the factors that have been studied in the academic literature (although some with very little rigour). The most important factors are discussed below.

Empirical effects[4]

We have analyzed the factors that influence performance after business transfer in a sample of SMEs that experienced business transfers between 1998 and 2003 and for which we have longitudinal data on performance.

Figure 3.6 Business transfer framework



Note: *Relationships and dependencies between categories I through IV are left out for transparency. Also the links between categories V and VI, and the links between categories VII, VIII and IX are not shown.*

Source: *EIM (Meijaard et al, 2005, The relationship between successor and planning characteristics and the success of business transfer in Dutch SMEs, EIM: Zoetermeer).*

Education, management experience and management training of the successor show positive effects on the success of business transfers (see Figure 3.7). Business transfer planning delivers positive results as well. Furthermore, the more formal preparation decreases the negative employment effects of the business transfers. On the other hand, the use of external consultants in the transfer process has negative consequences on performance in terms of productivity and innovation. Employment is safer when consultants and accountants are involved. These findings suggest that consultants and accountants assist the entrepreneurs that are more risk averse and less innovative. Of course we do not know whether this also means that the chances for long-term business success improve.

Figure 3.7 Determinants of post-transfer performance

	Sales growth	Employment growth	Productivity
Education of successor	+	-	0
Experience	+	- -	++
Management training	0	-	+ (LT)
Insider (more than 5 years in the company)	+ (LT)	0	-
Written business plan	++	+	0
External consultants	-	+	-
Intensity of Transfer Planning	+	0	+/-
Family owned (> 50%)	0	-	- (LT)

Note: *Based on separate regressions year-by-year. Marks ++ and - - denote a strongly significant effect (95%), + and - a weakly significant effect (90%), at least in 3 years. (LT) denotes: effects lagged 3-4 years.*

Source: *EIM, 2004 (Meijaard and Uhlaner, 2004, Een nieuw begin: Pilotstudie kosten en baten van bedrijfsoverdrachten, EIM: Zoetermeer).*

Planning

Based on the above results and various other sources of data in the Netherlands (EIM, ING, RZO) it is consistently shown that pre-transfer planning improves post-transfer business performance, especially sales growth. Probably planning also decreases the likelihood of exit (see the next chapter on business transfer policy). As is shown by the empirical evidence reviewed here, better business transfer is strongly helped by explicit planning. This may have various reasons. Firstly, a more conscious approach to business transfers makes it more likely that more than one alternative solution to the business transfer situation has passed the review. This is bound to improve the outcome. Secondly, planning is very likely to make the firm more transparent to the prospective successor. More relevant information will be readily available for purposes of due diligence and screening. This also improves the likelihood of successful business transfer. Thirdly, a planned business transfer will make the transfer process more transparent to employees and other stakeholders. This will reduce the chances of resistance or frictions towards management buy-ins, management buy-outs and family successors alike. Fourth, a planned business transfer will make the information available after the transfer more complete. Essentially, the 'briefing' of the successor will be more reliable.

Business transfers are often characterized by innovation and change. As depicted in Figure 3.6 above, these changes may concern strategic changes, structural changes, internal changes and innovations. The latter may concern entering new markets, introducing new products and services and improving the existing processes. Most new management and new ownership will aim at improving margins, finding new markets and rationalizing the internal processes. As a result, the type of business dynamics that is induced by business transfers is quite hidden, but all the more important. In time, the innovations and changes due to a business transfer are likely to pay off.

Productivity growth

Focussing further on the sample of SMEs that experienced business transfers between 1998 and 2003, interesting evidence is found on the post-transfer performance of firms. Employment in transferred firms shows a negative development. Apparently new owners streamline the processes. After business transfer firms show positive sales growth, at least in the short run. In the longer run, the effects remain positive, but less pronounced. Sales per full time employee (a measure of productivity) clearly grow in the years after business transfer, as can be seen in Figure 3.8.

Figure 3.8 Changes in productivity (real sales per full time employee)

	Productivity 1999	Productivity 2000	Productivity 2001	Productivity 2002	Productivity 2003
Year of transfer 1998	+	0	0	0	+
Year of transfer 1999	++	-	0	+	+
Year of transfer 2000		0	+	-	++
Year of transfer 2001			++	0	-
Year of transfer 2002				+	++
Year of transfer 2003					+
Non-transferred firms (as a benchmark)	+	-	-	-	0

Note: Marks ++ and - - denote a strongly significant effect (95%), + and - a weakly significant effect (90%).
Source: EIM, 2004 (Meijaard and Uhlaner, 2004, Een nieuw begin: Pilotstudie kosten en baten van bedrijfsoverdrachten, EIM: Zoetermeer).

A line of reasoning in this respect may be that the new entrepreneur manages to take away the clearest productive inefficiencies. The entrepreneur makes investments in strategic reorientation, restructurings and innovation[5].

Innovation

Interestingly, the innovativeness of the firms clearly grows in the first years after the business transfer. This is shown in Figure 3.9. In the first and second year after business transfer, innovation increases. Data for longer periods are not available yet, but the respective firms continue to be tracked by EIM.

Figure 3.9 Changes in innovativeness

	Innovativeness 2001	Innovativeness 2002	Innovativeness 2003
Year of transfer 2000	+	0	0
Year of transfer 2001	+	+	0
Year of transfer 2002		+	+
Year of transfer 2003			+
Non-transferred firms (as a benchmark)	-	0	0

Note: Marks ++ and - - denote a strongly significant effect (95%), + and - a weakly significant effect (90%).
Source: EIM, 2004 (Meijaard and Uhlaner, 2004, Een nieuw begin: Pilotstudie kosten en baten van bedrijfsoverdrachten, EIM: Zoetermeer).

Figure 3.10 **Key process factors determining in the introduction of innovations (new to the firm), by sector**

	Total	Manu-facturing	Construc-tion	Wholesale/ Transport	Retail	Hotels & catering	Knowledge int. services	Financial Services
Managerial innovation focus	+++		+++	++	+++	+++	+++	
Documented innovation plans	+	++						+++
Use of external networks	+++		+	+++	++			+
Market research	+++	++	++	+++			++	+++
Inter-firm co-operation	+++	++		+	+			

Note: +++= very strongly significant effect (99%), ++= strongly significant effect (95%), += weakly significant effect (90%).
Source: EIM, 2004 (De Jong and Vermeulen, 2004, Determinants of product innovation in small firms: A Comparison Across Industries, EIM: Zoetermeer).

Irrespective of a transfer situation, several additional factors are found to be conducive to the introduction of innovation in general[6]. These are important to newly transferred firms as well.

Research on the consequences of these innovation efforts indicates that knowledge creation and knowledge diffusion efforts are additional, important factors influencing the growth performance of small firms[7].

Performing market research and using an external network for knowledge exchange is associated with a higher sales growth. In addition, a positive effect is found for the improvement of internal processes. This indicates that a more efficient renewal process re-sults in a higher turnover growth.

For employment growth, firms that have a network for knowledge exchange at their disposal and firms that cooperate with other firms grow more than firms that do not cooperate or network. One might argue that being highly involved in cooperation and networking improves innovation and performance and it may for example shorten the process of finding qualified personnel to fill vacancies as well. Other positive effects are displayed by the codification of knowledge (documented innovation plans) and for example innovation training provided by firms. Writing down innovation intentions has an especially strong correlation with the employment for micro firms.

We find firm-size effects for holding patents, for applying constant renewal as part of strategy (sales growth), for codification of knowledge and for cooperation with other firms (employment growth).

Summary

The following stylised facts on SME business transfers in the Netherlands can be listed. Planning, particularly for non-family-firms, and a family-relationship between the predecessor- and the successor have positive effects on post-transfer performance. Negative effects on post-transfer profitability are found for business training, the use of outside consultants in the business transfer and firm size. Positive effect on post-transfer sales growth and innovativeness are found for firm size and business training, while negative effects on post-transfer sales growth and innovativeness are found if the successor is an insider to the firm and when outside consultants are used in the transfer process. Overall, we find that family transfers and buy-outs show increased profitability, yet stagnant sales and innovativeness, while buy-ins and non-family transfers show sales growth and increased innovativeness, but stagnant profitability.

3.5 Conclusion

Based on this chapter, we may conclude that more attention to business transfer as a 'normal' element of business dynamics is deserved. Substantial policy attention is paid to start-ups and "gazelles", but recently transferred firms are seldom included in policy initiatives. The above analyses show that attention to business transfers may well be an important element in policies to promote productivity growth and innovation since recently transferred firms are relatively innovative and productive.

Since innovation and growth are related to successful business transfers, better education of successors and better planning of business transfers may further improve the average and expected post-transfer performance of existing firms. A reduction in the overall number of exits and an increase in the overall number of business transfers would furthermore directly benefit the health of business dynamics and resulting economic growth.

A priori, business transfers may not seem to be a 'sexy' way to improve productivity and innovation. Nevertheless, recently transferred firms are more productive and innovative than incumbent SMEs or start-up firms. The barriers that predecessors and successors experience may be a relatively easy target for policies to support growth in the SME sector. Up-to-date knowledge on the specific and most pressing barriers in this respect is lacking.

Notes Chapter 3

[1] Management buy-ins and management buy-outs are examples of business transfer just as much as a transfer of business from father to son is.

[2] Bangma, Gibcus and van Eck van der Sluijs, 2005, *Bedrijvendynamiek en werkgelegenheid*, EIM: Zoetermeer.

[3] Population data and shares are based on the so-called MKB-panel, a representative, stratified sample of 2,000 SMEs in the Netherlands.

[4] Meijaard et al, 2005, *The relationship between successor and planning characteristics and the success of business transfer in Dutch SMEs*, EIM: Zoetermeer.

[5] Meijaard and Uhlaner, 2004, Een nieuw begin: *Pilotstudie kosten en baten van bedrijfsoverdrachten*, EIM: Zoetermeer.

[6] De Jong and Vermeulen, 2004, *Determinants of product innovation in small firms: A Comparison Across Industries*, EIM: Zoetermeer.

[7] Meijaard, Van Stel and Folkeringa, 2005, *Strategic Renewal and its Effect on Small Firm Performance*, EIM: Zoetermeer.

4 Business transfer: A policy perspective

by Yvonne Haane of the Ministry of Economic Affairs, the Netherlands

4.1 Introduction

Business transfers have been a priority of the entrepreneurship policy of the European Commission (EC) since the 1990s. The political interest for business transfers in the European Union (EU) member states has steadily grown since.
This is not surprising as Europe is "greying" and so is enterprising Europe. In the next ten years, the baby boom generation will reach pensionable age. Also, new types of entrepreneurship have emerged: the lifelong bond between entrepreneur and business, as existed directly after the Second World War, is slowly making way for new types of entrepreneurship. Entrepreneurs may leave their business early due to personal circumstances (e.g. death, illness), or quit their business to set up a new business instead (serial entrepreneurship).

The retirement of the baby boom generation and the emergence of new types of entrepreneurship have a profound impact on the European investment climate. Recent studies have shown that a third of all European enterprises will be transferred in the next ten years. This implies that on average 610,000 enterprises will change hands each year, affecting 2.4 million jobs[1].

The expected wave of transfers raises an important question: Who will take over these businesses? Research shows that not all business transfers in Europe are successful. In fact, at least 10% of all transfers in Europe lead to the unnecessary winding up of a viable business, and thus to unnecessary loss of employment and capital. This is food for thought for policy analysts all over Europe.

The EU first acknowledged the matter of business transfer of SMEs in 1994. This resulted in 21 recommendations to improve the fiscal and legal climate for business transfers in EU member states. By the middle of 2002, the EU analysed the progress made in the investment climate on the basis of the 21 recommendations. Also, it introduced new analyses and recommendations.

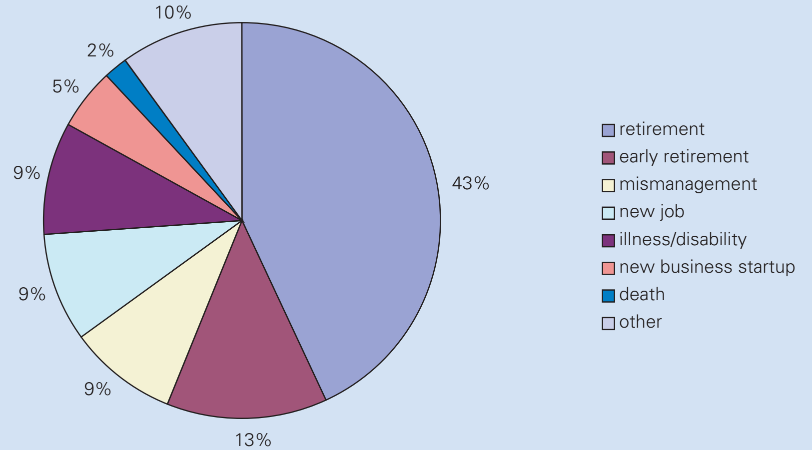
Policy makers in the Netherlands have likewise increased their interest in business transfers. The Netherlands is aware that it will - as its fellow EU member states - experience a wave of business transfers in the near future: estimates are that in the Netherlands only 18,000 business transfers a year will take place in the next ten years[2]. In the latest policy papers of the Entrepreneurship Department of the Dutch Ministry of Economic Affairs, *Action for Entrepreneurs! (In Actie voor Ondernemers!)* and its follow-up (published 2003 and 2004 respectively) facilitation of business transfers is a prominent policy issue. In these papers, the Dutch State Secretary of Economic Affairs calls for more and better business transfers.

This chapter describes the national policy of the Dutch government to improve the investment climate for business transfers. Paragraph 4.2 briefly touches upon the motives of transferors and transferees to engage in a transfer. Paragraph 4.3 describes the obstacles entrepreneurs encounter during the transfer process. Paragraph 4.4 describes what changes have been made in national legislation to adapt to business transfers. Support measures are described in paragraph 4.5 and the last paragraph rounds off with some conclusions.

4.2 Motivation

The motivation of entrepreneurs to transfer their businesses has changed over time. Whereas business transfers are often still triggered by the entrepreneur's retirement, personal reasons to transfer have become more important in recent years (e.g. early retirement, change of profession, mismanagement, or incidents). See Figure 4.1.

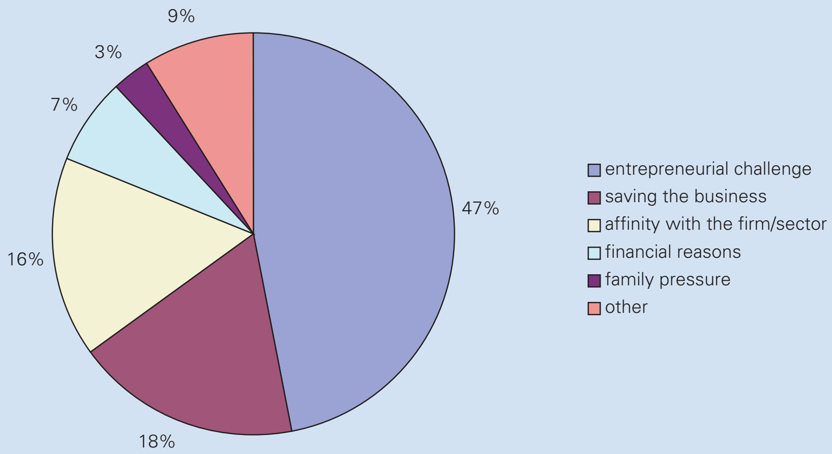
Figure 4.1 Motivation for the business transfer of the predecessor (the exiting entrepreneurs)



Source: EIM 2004, MKB-panel (SME-panel).

The main reason for the successor to take over a business is entrepreneurial challenge. See Figure 4.2. Other reasons are, for instance, saving the business and affinity with the firm or sector.

Figure 4.2 Motivation for the business transfer of the successor (the entering entrepreneurs)



Source: EIM 2004, MKB-panel (SME-panel).

4.3 Why policy is needed

As stated in paragraph 4.1, at least 10% of all business transfers in Europe leads to the unnecessary winding up of a business. This calls for improvements of the investment climate for business transfers in EU member states.
There are a number of obstacles that hamper successful business transfers. These can roughly be divided into three categories[3]: the complexity of the transfer process, national legislation, and psychological and emotional problems.

The complexity of the business transfer process

For the majority of entrepreneurs, a business transfer is a once-in-a-lifetime process. As the entrepreneur often has little or no transfer experience, he often does not know how to handle the transfer or to whom to turn for help when the moment of transfer arrives.
Yet, at the time of the transfer many important decisions have to be made: not only has the entrepreneur to decide when, how, and to whom he wants to transfer the business, but he also has to make the business ready-for-sale.
Before the valuation of the business takes place, the entrepreneur needs to make changes where necessary in the management, organisation, and in the fiscal, legal, and financial environment of the business. These may for instance include:

- Ensuring that the entrepreneur is not the sole person in the business who can take management decisions. A business on the transfer market needs to function well without the presence of the entrepreneur.
- Changes in the personnel: Where necessary, positions need to be altered, axed, or added.
- Change of the legal form. This can smooth the transfer and (or) ease the fiscal pain. Transfer of a private limited company is for instance easier to realise than transfer of a partnership.
- Improving the financial indicators (e.g. the solvency and the rate of return) of the business.

After the valuation, the entrepreneur needs to find a suitable buyer and close the deal. This also is a time-consuming and sometimes tough process. Negotiations on the price and conditions of the transfer have to be handled carefully.

Because of the complexity of the transfer process, entrepreneurs often cannot manage the transfer without the help of consultants. Consultants that assist business transfers are for instance tax specialists, accountants, jurists, and valuators. With the calling-in of consultants, however, the entrepreneur often runs into new problems, as the access of entrepreneurs to consultants in generally limited. Entrepreneurs often do not know who to contact or where to find information. This has several causes: the market for consultants is fragmented, expertise of different types of consultants overlaps, and only a small number of consultants focus on transfers of small businesses. Moreover, calling in the help of consultants is expensive, especially for small entrepreneurs.

National legislation

National legislation can impede the transfer process. In this connection one can mention company law, taxation, and administrative formalities. The European Commission has also cited gift and inheritance taxes, restrictions to changing the legal form of the business, and restriction of transfer to employees or third parties as main impediments.

Psychological and emotional problems

The most important reason for entrepreneurs not to prepare the transfer is an emotional one. Whereas the entrepreneur knows rationally it is wise to plan the transfer in advance, he nevertheless postpones the transfer to the very last moment.
Reluctance towards the transfer process has many reasons. Examples are:

- Awareness of one's own mortality. During a business transfer, the old French saying partir c'est mourir un peu holds;
- Loss of identity. Many entrepreneurs, especially those of small business, identify themselves with their businesses. The entrepreneur, so to speak, is the business and the business the entrepreneur. Stepping away from the business therefore feels like losing a part of one's identity;
- Fear of an empty life after retirement. Many entrepreneurs dread the day they have to exchange their daily activities for a non-active life. They feel useless when they are no longer an active member of society. Closely related to this phenomenon is that entrepreneurs dislike the idea of losing status and power after retirement.
- Occupation with day-to-day business. Entrepreneurs are usually busy with their daily activities and do not dwell upon a future transfer[4].

Emotional aspects are not only the main cause that entrepreneurs start preparing for the transfer late, they can also play a dominant role during the actual transfer process. They can for instance play a role when the old entrepreneur decides to continue to work in the business with the new owner. In a situation in which two captains are guiding one ship, conflicts may easily arise.
Emotional problems can be persistent especially in family businesses (see Box).

Family Businesses

The family business is a special type of business. Although everyone intuitively has an idea of what a family business is, or knows a family business from nearby, almost no one knows how to define a family business exactly.
In the Netherlands, the most common definition of a family business was formulated by Prof. Dr. Flören in 2002.
The Flören definition states that 'a business is a family business if it fulfils at least two of the following three criteria:
- A single family owns more than 50 percent of the shares or certificates.
- A single family is able to exercise considerable influence on the business strategy or succession decisions.
- A majority or at least two members of the Board of Directors or Board of Advisors are from one family.'

However, if the business was started less than ten years ago, at least one more family member of the owner(s) should either work in the business or own part of that business.[5]
According to this definition, 55% of all Dutch businesses are a family business. Family businesses have a number of special strengths and weaknesses. Most of these are related to the strong dependency of these businesses on the entrepreneur himself and his family. On the upside, family businesses are characterized by a stable culture and great commitment of the family. On the downside however, family businesses may be rigid and have to deal with emotional issues to a greater extent than regular businesses.
A transfer of a family business is often a difficult, sometimes even painful process. Owners start preparing their succession late as they have troubles letting their business go. Planning a business transfer creates many emotions: fear of death, loss of identity, but also jealousy and not being able to pick a successor amongst children are all factors that seriously obstruct the transfer process.
During the actual process of the transfer, family businesses have to deal with more issues than regular businesses. Next to questions of leadership, questions of ownership need to be tackled. Also, unsolved emotional problems between family members may come to the surface again during the transfer process.
Due to the specific problems family businesses encounter, these businesses are a special focus of the government during the design of new policy.

4.4 National legislation

The *Recommendation on the Transfer of Small and Medium Sized Enterprises* (1994) was the first document of the EC that called for specific attention for business transfers in the light of the imminent demographic changes[6]. The publication stated that the investment climate of the EU member states was still sub-optimal for business transfers. Hence, it proposed 21 recommendations. These recommendations included, among others:
- Improving the financial environment for SMEs by offering them suitable instruments for business transfer;
- Allowing SMEs to adopt the most appropriate legal status in order to prepare for transfer;
- Ensuring the continuity of partnerships and sole proprietorships when one of the partners or the business owner dies;
- Reducing inheritance and gift taxes;

- Encouraging transfer to third parties, e.g. by promoting the transfer to employees through the taxation system.

Since 1994, all EU member states have used these recommendations as a guideline to improve their investment climate for business transfers. Also the Netherlands has actively improved its climate for business transfers in the past ten years. The Netherlands was mentioned as one of the leading countries with respect to the implementation of the recommendations in a review of the EU of 2002[7].

4.4.1 The fiscal climate
Main changes in the fiscal climate concern the payment of inheritance and gift taxes and Individual Income Tax.

Extension of the exemption of inheritance and gift taxes
In the case of a business transfer through gift or inheritance, inheritance tax is due. However, sometimes there is not sufficient liquidity available to pay the amount of tax due. Therefore, money needs to be withdrawn from the business. This can have negative impact on the business. Sometimes the business even needs to be sold to meet the tax demands.
In order to prevent the negative impact of inheritance tax on the transfer of business, the Inheritance Act provides for a tax exemption upon the transfer of a business. The exemption has been increased from 30% (until 2004) to 60% (in 2005) and will increase to 75% (in 2007). Therefore, from 2007 onwards, gift and inheritance tax is due on 25% of the value of the business. For this 25%, a deferment of payment for a maximum of ten years can be granted.

Deferment of payment of Individual Income Tax
If the business is sold, in principle Individual Income Tax is due on the profit realized upon the sale of the business (transfer price minus book value). This includes amongst others hidden reserves and goodwill.
If the transfer price is due in instalments, the Individual Income Tax can be a fiscal obstacle. If the received instalments are not sufficient to pay the amount of tax due, deferment of payment can be granted for a maximum of ten years.

Silent transfer
As mentioned above, in principle Individual Income Tax is due on the transfer price minus book value (amongst others hidden reserves and goodwill) if a business is sold. *The silent transfer (geruisloze doorschuiving)* enables the entrepreneur to transfer the Individual Income Tax claim to the entrepreneur acquiring the business. The main conditions to be met are that the entrepreneur acquiring the business has been co-entrepreneur in the business for a minimum of three years, and accepts the transferor's balance-sheet valuation. In addition, the entrepreneur (seller) should be at least 55 years old or be unable to work for 45% of the time or more. The company can be transferred entirely as well as partially.
The *silent transfer* was extended in 1990 from heirs to third parties, such as employees.

4.4.2 The legal climate
The legal status of a business is crucial to the transfer process. Whereas the stocks of a private limited company can be transferred easily, participation in a partnership is more difficult to achieve. A number of legal facilities have, or will be introduced, to smooth the transfer process.

Formation private limited company

The Ministry of Economic Affairs and the Ministry of Justice are currently working on a bill to simplify and flex the law on private limited companies. This bill will be put forward in Parliament in 2006.
When the bill is passed, foundation of a private limited company will be simplified. The required minimum capital of € 18,000 will for instance be abolished. As it will become easier for the entrepreneur to start a private limited company in an early stage of his business, he can choose the legal status of the business to minimise the problem of transfer at a later date.

Continuation of a partnership or private limited company

The *Bill Partnership Law (Wetsvoorstel Personenvennootschappen)* was introduced to the Parliament in 2003 and is still pending. The Bill introduces a distinction between partnerships with and partnerships without legal personality. Moreover, it introduces a change of the principle that the partnership is dissolved if one partner ceases to be partner, unless the partners agree otherwise. In the *Bill Partnership Law* this principle is turned around: the partnership will be continued, and only be dissolved when the partners among themselves agree otherwise.

A shareholder in a private limited company, who wants to sell his shares, either needs permission of the board of directors or the general meeting of shareholders to sell his shares, or needs to offer them first to his fellow-shareholders. This way no third parties can join the private limited company unless there is approval of the board or the shareholders. The introduction of the *Bill Simplification Private Company Law (Wetsvoorstel Vereenvoudiging en Flexibilisering van het BV-recht)* proposes to facilitate the sale of shares to third parties. The bill no longer requires these forms of approval. The shareholders among themselves can of course agree to decide otherwise.

Conversion of the legal status

At the moment conversion of a partnership into a private limited company can only take place by bringing all assets and liabilities separately in the private limited company. The Bill Partnership Law allows for the transfer of a partnership with legal personality into a private limited company, i.e. all assets and liabilities are transferred at once. To this end a court procedure is needed.

Inheritance act

Up till 2003, the Inheritance Act puts the inheritance of businesses on a par with the inheritance of antique chinaware or a Persian carpet. In 2003, the Inheritance Act was changed, and now offers more possibilities for business transfers.

If the entrepreneur does not have a will, the Inheritance Act holds. This implies the spouse of the entrepreneur inherits the business. This can cause problems in a situation in which one of the (step)children (and not the spouse) works in the business and wants to continue it. The law, however, provides for a solution in this case: the (step)child who is business successor can request the other inheritors of the property of the business to pass this property on to him/her at a reasonable price. A judge takes the final decision in this case, by weighing the interests of the successor against the interest of the other inheritors.

If the entrepreneur does have a will, he can lay down that one of the children inherits the property of the business. In addition, he can record that the business successor is obliged to make up for (part of) the value of the property to the other inheritors. This way he will not disadvantage any of the inheritors.

4.5 Support measures

Support measures deal with both the complexity of business transfers and emotional and psychological problems. Support measures are therefore a necessary addition to changes in national legislation. There are three main categories of support measures: soft aid, establishment of a transfer market, and the finance of the transfer.

Soft aid concerns the provision of information to entrepreneurs, and to a lesser extent emotional guidance during the transfer process. EU member states have given different interpretations to the task of soft aid: from a large-scale awareness campaign on business transfers, to information meetings on transfers, to educational and training programmes, to coaching and counselling.

Examples of support measures in the Netherlands are:

Awareness campaign: Toolkit business transfers

As stated in paragraph 4.3, entrepreneurs often fail to prepare business transfers in a timely way or sometimes even at all. The Netherlands therefore launched in 2004 a large-scale campaign to draw attention to the need for timely preparation.
The campaign was a cooperation between the Ministry of Economic Affairs, the Dutch Chambers of Commerce, the *Royal Association for SMEs (MKB Nederland), and the Confederation of Netherlands Industry and Employers (VNO-NCW)*.
At the start of the campaign, all entrepreneurs aged 55 and older with less than 20 employees were sent a letter on behalf of the State Secretary of Economic Affairs. In this letter, their attention was drawn to the complexity and need for thorough preparation of business transfers. By means of a reply card the entrepreneurs could request a *Toolkit Business Transfers (Overdrachtspakket)*. This toolkit was made up of three brochures, named: *Start in Time, Business Transfer: The last Stage before the Finish, and Business Transfer: The Role of Consultants.* These brochures provided the information needed to take the first steps towards a smooth business transfer.
A total of 130,000 entrepreneurs were addressed. Entrepreneurs, who did not receive a letter from the State Secretary of Economic Affairs, but were interested in the information provided, could request a free copy of the toolkit through the Ministry of Economic Affairs or the Chamber of Commerce.
The campaign was an overwhelming success. Almost 40,000 toolkits were distributed. The entrepreneurs who received the toolkit rated the information provided positively.
The campaign has been re-launched in the fall of 2005. All entrepreneurs with less than 20 employees who celebrate their 55th birthday in 2005 have been addressed.

Counselling: Foundation Entrepreneurial Soundboard

The Foundation Entrepreneurial Soundboard (Stichting Ondernemersklankbord) is an organisation specialised in coaching and counselling SMEs with serious problems. The organisation exists of more than 200 retired entrepreneurs, general managers with entrepreneurial experience and experts, which provide assistance on a voluntary basis.

The entrepreneur can address the *Foundation Entrepreneurial Soundboard* in any phase of the lifecycle of his business. Providing assistance during the transfer process is one of the major occupations of the counsellors of the organisation.
The *Foundation Entrepreneurial Soundboard* is financed by private as well as public parties. The Ministry of Economic Affairs is one of its main sponsors.

Counselling: the Chambers of Commerce

The Ministry of Economic Affairs and the Dutch Chambers of Commerce actively cooperate to facilitate business transfers. The Chambers of Commerce have three main products available to the transferring entrepreneur:

- Brochures and booklets;
- Seminars, e.g. on succession in family businesses;
- Personal counsellors. The personal counsellor can help the entrepreneur to outline a plan for the transfer process. The counsellor can also bring the entrepreneur in touch with accountants, tax specialists, and other consultants.

The products of the Chamber of Commerce are offered to the entrepreneur for a low price.

Transfer Market: the Enterprise Exchange

Business transfers are a complex process, and the market on which these transfers take place is no less complex. One of the difficulties during the process is finding a suitable buyer. This is problematic, as an increasing number of transfers are taking place outside the family.
Part of the problem is that the market of business transfers is not transparent. The entrepreneur who wishes to sell his business, usually first looks for suitable buyers in his own discipline. If the quest is not successful there, he usually turns to his accountant, bank, or consultant. These often have their own database of buyers and sellers. Yet, the networks of accountants, banks, and consultants are often small and limited to their own customers. Sellers and buyers that make use of these networks are still excluded from a large part of the market.
The fragmentation of the market of business transfers is a concern for many EU member states. Several EU member states have therefore created an online database that matches buyers and sellers on the transfer market. The Dutch database is called *Enterprise Exchange (Ondernemingsbeurs)*.

The *Enterprise Exchange* was developed by the Association of Chambers of Commerce in cooperation with the Ministry of Economic Affairs in 2002.
This *Enterprise Exchange* acts as a host for clients, bidders and third parties. The Chambers of Commerce play a supportive role. Private organisations and entrepreneurs conclude the purchase/sales contracts themselves.
As the Chambers of Commerce charge entrepreneurs who make use of the *Enterprise Exchange* a low price, they can reach a large group of small enterprises that the private market fails to serve.
The *Enterprise Exchange* has on average 25,000 visitors a month. With 1,500 profiles of sellers and a network of almost 400 intermediaries, it is the biggest exchange in its kind in the Netherlands. The EU has cited the *Enterprise Exchange* as an example of best practise in promoting business transfers.

Finance

Businesses that change hands are usually larger than new enterprises at the time of formation. Therefore, the finance of a transfer is often more expensive than the finance of a business start-up. Although the Netherlands does not have specific loans or guarantees for transferees, transferees can (and do) make use of generic instruments available.
These are:

- *Riskcapital Scheme (Durfkapitaalregeling)*
  This scheme replaced an older scheme in 2001 and aims to increase the supply of risk capital for small businesses. This fiscal instrument makes it more attractive for private parties to put capital at the disposal of new businesses. The scheme provides for a subordinated loan of about € 50,000 at the maximum. A combination of loans to one company is allowed. The scheme is widely used to finance business transfers[8].
- *BBMKB*
  The BBMKB (Besluit Borgstelling MKB Kredieten) is a general guarantee scheme of the Ministry of Economic Affairs for SME financing by bank loans. The BBMKB is designed for businesses that have difficulties obtaining bank loans due to lack of collateral and the absence of a track record. Thanks to the BBMKB, banks can still provide loans to this group of relatively unattractive borrowers.
  Business transfers are an important target group of the BBMKB. The guarantee is maximum € 1,000,000 per SME.
- The Ministry of Economic Affairs is currently developing a growth facility, which will provide a 50% guarantee on risk capital (subordinated loans and share capital) provided by banks and venture capitalists to SMEs on financing amounts up to € 5,000,000. Business transfers will be a special focus of the facility.

4.6 Conclusion

Business transfers are a priority for policy makers throughout Europe. Because of the wave of transfers to be expected in the near future, the interest in this topic has increased in recent years.
In the Netherlands business transfers have also become a spearhead of entrepreneurial policy. At least 18,000 businesses a year are expected to change hands in the next ten years. The current State Secretary of Economic Affairs calls for more and better business transfers, through changes in national legislation as well as through support measures. In this connection the issue of the successful *Toolkit Business Transfer* as well as the increase in the exemption of gift and inheritance taxes can be mentioned.
The Netherlands will continue to design new measures. As stated in paragraph 4.4.2., the private company law will become more flexible and be simplified. Finance measures that are attractive to transferees are under development or being improved. Also, the Ministry of Economic Affairs is investigating how to make it even easier for entrepreneurs to call in the help of consultants, by, for instance, setting up open house days at the Chambers of Commerce where entrepreneurs and consultants meet.
In short, the Netherlands has actively sought to improve investment climate for business transfers. Significant progress has been made in various fields. New measures show that the Netherlands strives to optimize the climate for transfers in the future.

Notes Chapter 4

[1] European Commission, *Final report of the expert group on the transfer of small and medium-sized enterprises*, Brussels, May 2002.

[2] Kersten, L., *Business Transfers and Acquisitions*, NIPO Report A8968, commissioned by the Chambers of Commerce, Amsterdam, November 2001.

[3] European Commission, *Final Report of the Expert Group on the Transfer of Small and Medium-Sized Enterprises*, Brussels, May 2002.

[4] Flören, R., *BDO Accountants and adviseurs Cijfers en feiten van het familiebedrijf 10 jaar onderzoek onder familiebedrijven*, 2002.

[5] Flören, R., *BDO Accountants and adviseurs Cijfers en feiten van het familiebedrijf 10 jaar onderzoek onder familiebedrijven*, 2002.

[6] European Commission, *Recommendation on the Transfer of Small and Medium Sized Enterprises*, Brussels, December 2004.

[7] European Commission, *Final Report of the Expert Group on the Transfer of Small and Medium-Sized Enterprises*, Brussels, May 2002.

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5 Policy implications of business transfer patterns in a developed economy

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5.1 Introduction

Relative to historical trends, the rates at which businesses are either exiting or transferring to new ownership are high in Western economies, and are likely to continue rising. This pattern is due not only to the aging of the populations in these countries, but to the general nature of modern economic life. Today's business context is characterized by rapid technological change, fragmentation of markets, and growing levels of turbulence in competitive, social, economic, labor, and supplier environments. As a result, new ventures are created, succeed, and exit at a higher rate and over a shorter average life span. Stated differently, the life of a typical business under a given owner or ownership group is not as long as in the past, and this trend is likely to continue. As such, the rate of business transfers is a sign of economic health. A dynamic economy is characterized not only by high rates of start-ups and failures, but also by high rates of transfer.

Yet, a number of positive and negative externalities can result from transfers both when they happen and when they fail to happen. 'Successful' transfers can actually result in the elimination of jobs and assets, at least in the short-term. However, they can also produce heightened levels of innovation, improved efficiencies, and a stabilizing influence on local economies. Where transfers fail to happen, at least for many marginal and low valuation firms, it may well be that societal resources are subsequently reallocated to what is arguably a more productive use. Yet, there are clearly viable businesses that exit the market resulting, at least in the short-term, in job elimination and either the sidelining or destruction of assets. These business exits can also create psychological and social ill-effects on communities.

Semantically, the word 'transfer' is both a noun and a verb. As a noun, the interest is in how many businesses change hands in a given time period. As a verb, the concern is with the various methods and processes by which a business is transitioned to new ownership. In the pages that follow, we will explore both aspects of the term. The chapter will examine the extent to which transfers represent a serious issue warranting greater attention from public policymakers. In addition, we will assess whether enough is known to make informed decisions regarding how to influence the quantity and quality of successful transfers. Some priorities in terms of how researchers and public policy makers approach the transfer issue will be suggested.

5.2 Definitional issues: What are we really talking about?

The term "business transfer" is quite broad and covers significant territory including succession, transition, sale, and the absorption of an enterprise. Our focus in the current discussion is the transfer of small and medium-sized enterprises (SME's). Meaningful progress requires that we first achieve greater clarity regarding the subject matter. The European

Commission (2002) suggests the following definition: "A business transfer is understood as a transfer of ownership of an enterprise to another person or enterprise that assures the continuous existence and commercial activity of the enterprise." A transfer implies a particular business is developed by one person and managed and controlled by another party subsequently. Transfers are based on a wide range of motives, ranging from the owner's wish to cash out, retire, or escape the pressures and responsibilities of ownership, to the desire to create a new venture. The transfer can involve a transition of ownership and management 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 (sale or merger).

The failure to transfer does not mean the failure of the business. More often than not, the closure or exit of an enterprise is a choice made by the entrepreneur when the business itself is still quite viable. Similarly, the occurrence of a bankruptcy filing does not necessarily mean that an exit takes place, as many ventures continue to operate following bankruptcy, and the proceedings most often do not result in a transfer. These distinctions help explain the limited amount of statistical insight into the problems and opportunities surrounding business transfer. The available data, especially that available for cross-national comparisons, is inconsistent in terms of making such distinctions.

Perhaps the most complex definitional issue concerns the meaning of a "successful transfer". Success is obviously in the eye of the beholder. However, the metrics for success relate both to the transition of the business and the subsequent performance of the business. With regard to the former issue, is a transfer deemed successful if it happens, or is it a question of how it happens? Much attention has been focused on the reported 10% of transfer situations that result in an unnecessary closing of a viable business. Is a business that could have transferred but instead exits defined as a failed transfer? Does failure imply a transfer was attempted but could not be consummated? In terms of the latter issue, there is little agreement regarding what is a reasonable time period over which to gauge performance, much less whether the more appropriate indicators of performance are revenue growth, profitability, asset growth, employment growth, innovation and new product development, new market development, or some other metric.

5.3 Is there a problem?

That a significant increase in transfers will take place in the coming decade appears reasonably well established. Implicit in the earlier papers is an assumption that something must be done at the public policy level to address this trend - that is, the authors conclude it represents a significant problem for the EU and the Netherlands. Richer insights are needed, however, into the nature of the problem. Exhibit 5.1 provides an overview of some of the key issues that contribute to the complexity of the transfer challenge. As we attempt to decipher these issues, a beginning point is to distinguish the *quantity* of transfers as well as the *quality* of transfers.

The quantity of transfers

On the quantity side of the problem, a core question seems to concern whether the large increase in sellers (or those wishing to transfer their business) will be met with a relatively smaller increase in buyers (or those wishing to acquire a business). This pattern could dampen the price for businesses being sold, and, relative to the financial and non-financial costs associated with the transfer, encourage entrepreneurs to a) keep the business in the family (assuming this is at all viable), or b) shut down the business. Some may worry that this surplus of businesses in need of transfer will attract buyers (or heirs) who are less qualified to successfully run the business. Further, there appear to be concerns that many entrepreneurs are less prepared for transfer, and that this lack of preparation will ultimately result in a growing number of businesses that fail to transfer, or that transfer in an unsatisfactory manner. The implication in each of these instances is that society will be ill-effected by the disappearance of those businesses not successfully transferred (e.g., by job losses and losses of firms that are important contributors to the fabric of a community).

One is tempted to argue that quantity issues should be adequately addressed by the marketplace, so long as an efficient marketplace exists. Hence, a large increase in the supply of businesses to be transferred coupled with a smaller increase in the supply of buyers will be addressed through the price mechanism. Similarly, the marketplace will reward those entrepreneurs who are better prepared for transfer and penalize those who are less prepared.

This assumes, of course, the existence of a free, competitive marketplace. There are reasons to believe the market may not be all that efficient. Information regarding both the availability and quality of buyers and sellers is frequently not available on a timely basis to those on the other side of the transaction. Similarly, many entrepreneurs lack information regarding how to transfer a business. Another problem is the lack of venues at which transfers can be affected and businesses can be bought and sold. Separately, regulatory and tax policies create marketplace distortions in terms of the real price of a transfer.

Yet, there are some disturbing patterns in terms of the quantity of transfers. It is interesting to compare data from the United States to the statistics cited by Meijaard. Two overarching differences emerge from this comparison. The absolute number of transfers in the U.S. tends to be fairly close to both the number of exits and the number of start-ups. For instance, in 2003, there were over 750,000 new firms, 554,800 exits, and an estimate that over 600,000 transfers took place (Grant Thornton, 2005; U.S. Small Business Association, 2005). In the Netherlands, as Meijaard notes, transfers far lag both start-ups and exits. Holmes and Schmitz (1990) have concluded that economies experiencing lower population growth rates will also have lower rates of transfer activity, which may explain part of the pattern. Immigration clearly can off-set this pattern, with immigration rates higher in the U.S. Moreover, even if Dutch entrepreneurs keep their businesses for longer time periods (which may actually be less the case given that the Dutch retire at an earlier age), this disparity reinforces arguments that more exits should result in transfers. Other differences may also explain these patterns, such as a greater tendency in the U.S. to start businesses and sell them after a few years either for the purpose of a short term capital gain or because the entrepreneur intends to start yet another venture. In addition, the market for acquiring businesses is large in the U.S., with significant financial and legal infrastructure to support such transfers. Favorable capital gains treatment and tax policies are another potential contributing factor. A second comparative insight concerns start-ups. Whereas in the U.S., the number of new firms has consistently outpaced the number of exits, within the Netherlands exits have been outpacing start-ups. While it could be argued that the difference is not that significant, it might also suggest that the opportunity to move firms from the 'exit' category to the 'transfer' category in the Netherlands may not be as great as Meijaard suggests - that the exit rate is close to a 'natural rate'. This is, of course, purely speculative, and Meijaard makes an important point about the number of higher value firms that seem to be exiting. At the same time, the lagging start-up rate suggests the real priority should be a higher rate of creation of *sustainable* ventures.

Exhibit 5.1 Key Issues on the Demand and Supply Side of Business Transfers

Supply-side Issues	*Demand-side Issues*
- The growing *quantity* of candidates of transfer	- Potential shortfalls in the *quantity* of demand for transferred businesses
- The mixed *quality* of the supply of candidates of transfer	- The mixed *quality* of demand for transferred businesses
- How to best segment the population of candidates for transfer	- The implications of differences in transfer processes (and needs of the acquirer) when the business is acquired by heirs, independent entrepreneurs, and corporations
- Understanding how different motives for owning the business affect transfer decisions	- How to properly value firms that are candidates for transfer
- How to properly value firms that are candidates for transfers	- How to properly prepare heirs and new owners
- How to properly prepare entrepreneurs for business transfer or succession	- Negotiation skills when acquiring a venture
- Negotiation skills when dispensing with a venture	- Understanding how different motives for acquiring a venture influence approaches to transfers
- Inadequate knowledge and awareness of prospective buyers	- Financing challenges in acquiring a venture
- Timing issues regarding when to transfer the firm	- Regulatory and tax disincentives when acquiring a business
- Motivational issues in decisions to transfer or exit, including willingness to let go	- Liability issues for the acquiring party for actions and obligations of the business prior to its transfer
- Exit strategies of business owners and how they relate to transfer activities	- Shortcomings in terms of the entrepreneurial skills and growth orientation of the heir or acquiring party
- Regulatory and tax disincentives when selling a business	

Transfers should also be examined in the context of business failure and business growth. Shane (2003) notes some key patterns. In the U.S., over 750,000 businesses are started each year. About 40% fail to survive more than one year, 64% fail to survive five years, 75% do not last eight years, and 88% do not survive past nineteen years (Shane, 2003; Timmons and Spinelli, 2004). Most of these exits are non-sustainable businesses. What remains unclear is the extent to which efforts to foster transfers can be expected to reduce failure rates. Failure occurs because of a bad business concept, inappropriate timing, poor management, intense competition, and resource inadequacies, among other causes. As such, most failures are simply not transferable businesses.

It should be further noted that less than 10% of start ups ever achieve any real growth in assets or employees, while less than 4% create more than 100 jobs over their entire existence. At issue is the extent to which the tendency to not transfer is more prominent among no-growth and low-growth businesses. I believe this is overwhelmingly the case in most developed economies, suggesting converting exits to transfers may not offer much promise. However, Meijaard indicates that a meaningful proportion of exits in the Netherlands are older firms with more employees, and hence are viable transfer candidates. His argument centers more on company size and age, though, while it may be that growth patterns are a better indicator of transfer potential.

In a related vein, one might ask if it is a failure from a societal standpoint when a business that could transfer instead exits. There generally seems to be a conviction in the earlier chapters and the reports from the European Commission that business exits are not a good thing, and that a large number of those who exit actually should have been targeted (ostensibly by public policy initiatives) for transfer. In actuality, business exits are a sign of economic health, reflecting a dynamic flow of ventures into and out of the market. Businesses exit for a plethora of reasons, and these departures are not only an important source of learning on the part of entrepreneurs and investors (which may lead to the launching of subsequent ventures) but also open up market opportunities for others. Certainly some percentage of these exits might be preempted to the benefit of society, but overreacting to them reflects a type of resistance to change and a stifling of the underlying dynamics of a free market. Moreover, while one is always disturbed by job losses, in this case from exits, statistics such as those cited by Meijaard can be misleading. First, insights are needed in terms of the types of jobs lost and how quickly and easily these individuals were re-absorbed into the job market. Second, comparing job losses from exits to job gains from start-ups ignores the jobs that will subsequently be created by those start-ups as they grow, most notably the 10-15% that can be expected to grow aggressively.

The quality of transfers

The issue can also be approached in terms of the *quality* of transfers. Here, the concern is not so much the volume of transfers and marketplace efficiencies as it is the impact of a transfer on the entrepreneur and his/her successor, the business, the community, the economy, and the larger society.

Arguably, quality has many dimensions when it comes to the transfer of a business. A high quality transfer is one that takes place on a timely basis, involves little to no diminution of firm assets (and perhaps enhances those assets), has a neutral or positive impact on the competitive ability of the firm, benefits both parties to the transfer at a level equivalent to or in excess of what they give up, entails minimal stress, incurs reasonable transaction costs to both parties, and positively impacts the economy both directly and through any multiplier effects. Many of these dimensions can involve trade-offs. Hence, a transfer that enhances the value of firm assets may take longer to complete, and one that results in high levels of benefit to both parties may involve more stress. Further, there are degrees of quality involved in any transfer.

The likelihood of a transfer, as well as its quality, should be directly associated with the quality of the business in question. Holmes & Schmitz (1990) suggest that, for a cohort of new businesses developed at a certain date, those that are subsequently involved in a transfer will on average be of higher "quality" and also survive longer than those that are not transferred. The implication for public policy, if any, is that not all businesses are equal, and that government should do more to support growth-oriented start-ups. Yet, if anything, public policy intended to encourage entrepreneurship (typically defined in terms of gross numbers of start-ups) often makes no distinction in terms of where the business is going. Thus, new start-ups and the protection of lifestyle ventures are supported, while growth may be penalized, even if unintentionally. Policy makers can fail to recognize that small businesses per se contribute relatively less, while growth-oriented small businesses account for the lion's share of jobs, wealth, innovation, patents, and quality of life improvement in society. As a case in point, in a separate monograph, we demonstrate in the U.S. that the costs of regulation and the tax burden fall disproportionately on growth-oriented small businesses, creating strong incentives to remain small in terms of employees, sales, locations, and other measures of growth (Morris et al., 1996). An exception is initiatives that specifically target high technology firms, on the implicit assumption that they are inherently more growth-oriented.

The quality of the transfer is also linked to the quality of the party that takes over the business. While one might be tempted to assume that firms bought by external sources, most notably those that are acquired by established firms, will have lower failure rates, the record on post-transfer performance is mixed, as shall be discussed later. Much depends on the motivation of the acquiring firm for making the acquisition, and the extent to which business focus of the acquiring firm is related to that of the acquired firm. Within a family-owned business, we need better methods for measuring what constitutes a 'well-prepared heir' and especially for distinguishing their managerial or executionrelated skills from their entrepreneurial or innovation and growth skills. In addition, little in the way of statistics is available regarding the general preparation level of heirs. Evidence exists that preparation levels do influence both the transfer quality and post-transition performance (Morris, et al., 1997).

Our ability to understand the quality problem also requires richer insights into the reasons that entrepreneurs transfer their businesses. One must be careful when interpreting the statistics regarding reasons for transfer. As Haane notes in Figure 4.1 of her chapter, retirement, early retirement, mismanagement, new jobs and other factors are cited as reasons for 'disposing' of the business. However, these factors seem more concerned with what the entrepreneur is planning to do next, as opposed to what is motivating the entrepreneur to pursue the transfer as a course of action. It is important to ask why one has decided on early retirement, or to pursue another venture. Stated differently, the motives for business transfer among exiting entrepreneurs are more complex than is being allowed for. Thus, the promise of a large payout, the sense of reassurance that the business will be in good hands, the perception that the transfer process is relatively easy, the perception that one has done all he/she can with the venture, boredom or fatigue, some adverse personal or businessrelated development, and the perception that the business is worth more today than it may be in the future are examples of motivating factors. Tax and regulatory issues can clearly influence these motivations. Just as important in explaining motivation is whether the transfer is part of a longplanned exit strategy or is more of a situational decision.

On balance, it would seem that policy makers should be cautious in attempting to influence business transfers. There appears to be some sentiment, as reflected in the European Commission's report on business transfers published in 2002, that the issue of transfers should receive attention equal to that of fostering start-ups. This seems to me to reflect misplaced priorities. The marketplace will generally address issues of supply versus demand. Yet, there are opportunities for public policy makers to add value to the transfer process, and especially to influence the quality of transfers. The beginning point is to segment the marketplace.

5.4 A heterogeneous population

It is dangerous to generalize about transfers, as the enterprises changing hands in a given time period are not a homogeneous group. Accordingly, effective public policy in the commercial arena should not embrace a "one size fits all" approach. Rather, it is vital that policymakers recognize that different segments of the transfer community require different solutions.

There are many ways in which to partition transfers. Five approaches would appear especially relevant from a public policy vantage point.

a. Form of Disposition of the Firm - A transfer can take place in at least six different ways, with variations possible within each method. Included here are: 1) business succession within family business to an heir, 2) management or employee buy-out of firm, 3) acquisition by entrepreneur, 4) acquisition by established company, 5) sale of assets to third party, 6) university spin-offs. The financial, legal, tax, training, and informational problems of the parties to the transfer can vary considerably depending on which of these forms of transfer is involved.

b. Valuation/Performance - Arguably the most important distinction when considering transfer policies concerns whether we are dealing with a survival, lifestyle, managed growth, or high growth venture. The vast majority of SME's have fewer than five employees, and most are limited to the owner-manager as sole employee. Further, while less than 15% of start-ups result in a high growth venture, in dynamic economies that sub-group is responsible for the overwhelming proportion of net new jobs created in society, the largest proportion of patents, and the lion's share of product, service and process innovations. Accordingly, their valuations tend to be much higher. It would seem to be a far more serious challenge for society when these highly entrepreneurial firms fail to successfully transition to new ownership and leadership. Yet, transfers are less a problem with these ventures, at least insofar as their being ample demand to acquire them. The bigger concern might be the extent to which such ventures are absorbed by larger companies, and these larger entities subsequently eliminate jobs, drop products, or sell off key assets.

c. Transfer Initiator/Transfer Motives - The transfer process can be initiated by the entrepreneur or management team in the enterprise being transferred (seller or current head of the family business), by the person or organization acquiring the enterprise (buyer or heir), or by some third party such as a supplier or financial institution. Data is not available on the proportion of transfers initiated by each party, and whether the quality or outcomes of the transfer varies depending on the initiator. Different types of initiatives are likely to impact the behavior of each of these parties. A related perspective is to distinguish transfer situations where the current owner/entrepreneur is *pushed* versus *pulled* into a transfer situation. Push factors could include illness, fatigue, age, declining markets, intensifying competition, financial exigencies (related either to the problematic performance of the business or personal finances of the entrepreneur), and family pressures, among others. Pull factors are more opportunity-driven, and might include a proactive buyer, the opportunity to achieve a financial windfall, the ability to take advantage of some regulatory or tax rule to the entrepreneur's advantage, or the chance to enhance the development or motivation of one's offspring or heir.

d. Key Industries - Particular industries may warrant unique forms of attention when it comes to the question of transfers. Not only are some industries more able to impact employment and economic growth than are others, but a host of other societal goals may be better served by discriminating in favor of certain industries in trying to facilitate more and better transfers. The bases for such prioritization in policy are many. Whether it relates to national defense, protection of cultural traditions, the development of particular industry clusters where the country has comparative advantage, the desire to stimulate the advancement of certain technologies, or the need to protect certain ethnicities or other segments of the population, it may be that not all industries are equal in terms of the implications of the companies within them failing to transfer.

e. Stage of Life Cycle - While some attention has been devoted to the age of the firm being transferred, age is not always a good proxy for the stage of development of the business. A simple distinction can be made between ventures that are at the start-up, early growth and stability, rapid growth, and resource maturity stages of development. The need for distinctions based on life cycle stage is reflected in the Action Programme on Entrepreneurs put forward by the Dutch Ministry of Economic Affairs.

While I believe these are the most valuable ways to break down the marketplace for ventures, other ways to segment the population of businesses that might transfer include the extent to which the business operates domestically or internationally, is engaged in business-to-business or business-to-consumer operations, are high-, medium-, or low-tech. Each has different potential implications for public policy. The point is that generic policies that are not targeted to particular types of ventures and transfers are likely to have much less impact and will waste much more in terms of resources.

5.5 The unique case of family business succession

Although it represents a markedly lower percentage than in the United States, family-owned business constitute better than half of all businesses in the Netherlands. For this large population of businesses, an important transfer option is to pass the business along to heirs. Family member succession actually occurs in a surprisingly low proportion of family businesses. While estimates vary, it is generally believed in the U.S. that close to 70% of family businesses do not make it to a second generation, 85% do not get to a third generation, and 97% fail to reach a fourth generation.

Research on succession processes in family businesses has tended to be conceptual and/or case based, and highly normative, with little in the way of systematic attempts at comprehensively specifying or classifying the factors associated with effective transitions. Nonetheless, a number of such factors have been identified. These factors can be organized into three general categories, as summarized in Exhibit 5.2.

The first category, emphasized by Meijaard and the one receiving the greatest amount of attention from researchers and consultants, concerns planning and control activities. Succession planning, in particular, receives extensive emphasis in the family business literature. Topics covered include the structure and review of such plans, who should participate in their preparation, when they should be prepared and contingency issues in planning. Other issues in this general category include ways to avoid taxation liability, the structuring of wills, the use and constitution of boards of directors, the potential roles of family business consultants, and the establishment of a family council.

The second category In Exhibit 5.2 involves the preparation level of heirs. Work in this area addresses the extent to which heirs have the requisite business skills, managerial capabilities, knowledge of company operations, and attitudinal predisposition to handle the running of the business. Specific variables of importance include the heir's formal level of education and training, years of work experience in the firm and in other firms (within and outside the same industry as the family firm), entry-level position, number of different positions held (e.g. at different levels and different functional areas within the firm), years employed by the firm, motivation for joining the firm, and self-perceptions of his/her preparation level at the time of actual succession.

A third category is concerned with personal relationships within the family and between family and non-family employees of the firm. It is a factor that is relatively under-emphasized in Meijaard's excellent attempt to summarize issues that surround business transfers. The principle issue here concerns trust and communication among family members. The potentially dysfunctional outcomes of sibling rivalries and/or failure of siblings to accommodate one another has also been highlighted in the extant research. Refusal of the head of the family business to let go, or to share power in incrementally increasing degrees, as well as his/her resentments of heirs are related topics receiving focus. The importance of shared values, agreement regarding what is equitable, and common traditions across family generations has been emphasized as well.

Exhibit 5.2 Three Primary Categories of Factors Affecting Successful Family Business Transitions

Category I: Planning and Control Activities

- Succession planning
- Tax planning
- Use of outside board
- Use of family business consultants/advisors
- Creation of a family council

Category II: Preparation Level of Heirs

- Formal education
- Training
- Work experience (outside firm)
- Entry-level position in firm
- Number of positions held within the firm
- Year working within firm (and/or industry)
- Motivation to join firm
- Self-perception of preparation

Category III: Relationships among Family Members

- Open communication
- Trust
- Commitment
- Loyalty
- Family turmoil
- Sibling rivalry
- Jealousy/resentment
- Conflict
- Shared values and traditions

These three categories capture the key variables affecting transitions and over which the family firm has some direct control. There are, of course number of "external variables" also influencing transition success, such as market demand conditions, the state of economy, buy-out offers from potential suitors, and financial pressures from lenders and other resource suppliers. It should also be noted that there are potential overlaps among the three proposed categories of variables. For instance, a good succession plan may result in heirs that are better prepared.

Using these factors, our own research suggests a number of interesting characteristics of successful transition in family-owned businesses (see, for example, Morris, et al., 1997). First, heirs in these firms tend to be reasonably well-prepared, both in terms of their educational background and experience. They tend to start at the bottom in the company and to spend a number of years serving in a variety of capacities throughout the organization. Second, relationships within the family are generally positive, with limited levels of conflict, rivalry, or hostility. High levels of trust and shared values are in evidence. Third, planning and control activities tend to be informal, with considerable emphasis on tax planning and relatively little on succession planning. Similarly, there is little reliance on boards of directors, advisors or outside consultants.

The fact that formal succession plans are not prepared does not necessarily mean that there is an absence of planning. It may be that "plans" exist but are more open, fluid and unstructured. Further, they may be subject to ongoing adaptation and change based on family relationships or undercut motivation. In addition, the nuances of such plans may have resided more in the mind of the predecessors, with many details never shared with the successors or other involved parties.

Overall, the evidence supports the argument that transitions occur more smoothly where heirs are better prepared, where relationships among family members are more trust-based and affable, and where family businesses engage in more succession-related planning. Of these three, however, the nature of family relationships appears to be the most significant factor. In spite of the considerable emphasis, especially in the extant literature and contemporary consulting practice, placed on succession and tax planning, it appears that one's first priorities should be building trust, encouraging open communication, and fostering shared values among the family members themselves. Failure to do so creates a situation where "soft matters become hard ones" Malinen (2004). Thus, greater attention in efforts to foster intra-family transfers should be given to the human element, the complex relationships that dynamically unfold, and the corresponding need for interventions aimed at establishment and maintaining family cohesion.

5.6 The post-transfer performance issue

Generating more or fewer transfers may be less relevant than creating circumstances where ventures either maintain or improve their levels of performance after the transfer. While there is evidence that the nature of transfer processes can influence post-transfer performance (e.g., Morris, et al., 1997), the work to date has failed to capture the nuances of different types of transfers, different indicators of performance, and different contextual factors surrounding both the transfer and the circumstances of the firm in the post-transfer period.

The assessment of performance typically involves measures of revenues, profits (e.g., net earnings, return on assets or equity), growth in assets, or increases in employment. However, interpretations must consider performance relative to the *pattern* in pre-transfer performance and relative to the evolving competitive context within which the firm operates. There is, of course, a temporal aspect here. It may take time for synergies to be realized between new management and the existing firm, or for the firm to be integrated into the operations of an acquiring firm. It also might be worth considering other aspects of performance, such as the successful launch of new products, penetration of new markets, or formation of new partnerships or alliances that move the firm into new competitive realms.

Post-transfer performance is likely influenced by the entrepreneurial orientation (EO) of the firm. Evidence exists to suggest that venture performance is correlated with levels of EO (Kreiser, et al., 2002). EO captures how entrepreneurial a firm is over a given time period, as reflected in the firm's innovativeness, risk-taking and proactiveness. It is worth considering the level of EO both before and after a transfer has occurred. I believe that many of the firms that are not viable transfer candidates, ones that otherwise fail to transfer, or those that transfer unsatisfactorily demonstrate low levels of EO. Moreover, the loss of the original entrepreneur or key members of the management team can lead to a reduction in the firm's EO. Alternatively, new management may bring a much stronger entrepreneurial orientation than previously existed. Where high levels of EO are achieved in the post-transfer environment, the likelihood of new products, processes, markets, technologies and, ultimately, new jobs, is greatly enhanced. Thus, the real policy question might be "how can we facilitate transfers to company environments that demonstrate enhanced levels of EO?"

One recent stream of research is quite promising as we try to better understand performance-related issues (Anderson and Reeb, 2003; Anderson, Mansi and Reeb, 2003). In an examination of companies belonging to one of the major U.S. stock indexes (the Standard and Poor 500) Anderson and Reeb (2003) found evidence that family-owned firms actually perform better than non-family firms, and investors tend to value them more highly. Further, family-ownership has been associated with a lower cost of debt financing (Anderson, Mansi and Reeb, 2003). The authors of these studies suggest that ownership structure, board composition (and especially the presence of independent directors), background of the CEO, and financing structure have important implications for the relative performance of these two types of firms. One implication of this research stream is that policy efforts intended to affect transfers might prioritize keeping the business within the family.

5.7 Public policy opportunities: Different roles for government

What is the role of government in the transfer process? The implication in the two preceding chapters and in the European Commission's various reports on transfers is that the government should be fairly proactive. One reason for the variances among EU countries in the extent to which they have acted on the recommendations coming from the European Commission is that the nature of this role has not been defined, on the one hand, and there are diverse opinions regarding what this role should be, on the other hand.

It would seem the government role can take many forms, but the nature of the initiatives proposed or implemented to date suggest this role might take one of five overall postures:

- *Enhancing the efficiency of the private sector marketplace for businesses:*
  The focus here is two-fold: a) imperfect information and imperfect competition, and b) correcting distortions in the marketplace created by existing tax and regulatory policies. In the first case, governmental efforts are concerned with the need to create greater transparency and dissemination of information regarding buyers with the willingness and ability to buy and sellers with the willingness and ability to sell. Moreover, marketplace venues for buying and selling are created. Initiatives in this context tend to focus on establishing databases of sellers and potential buyers, the creation of exchanges where business transfers can be transacted, and mechanisms to ensure valuations are placed on businesses that reflect competitive market conditions. In the second case, policymakers attempt to lessen those tax and regulatory constraints that to serve to artificially distort the real price attached to a transferred business.

- *Attempting to reduce the number of failed transfers:*
  In this case, government policy concentrates on helping to better prepare entrepreneurs and their ventures for transfer. Educational programs for entrepreneurs, access to qualified and affordable consultants, easing of constraints on changing the form of business, and reductions in estate tax schemes that absorb much of the working capital of an ongoing firm are examples of initiatives in this vein.

- *Encouraging an increase in the absolute number of transfers:*
  By increasing the incentives for transfer (e.g., through deferred tax schemes), or reducing the disincentives (e.g., through lessened regulation and reductions in tax rates), government policies can serve to a) encourage more entrepreneurs to sell their businesses than otherwise might be the case, or b) can encourage more buyers or acquirers to enter the market.

- *Encouraging transfers of particular types of businesses:*
  Based on one or more of the segmentation schemes discussed earlier, government encourages the transfers of targeted groups of small businesses, most notably those that are producing more innovation, or achieving meaningful growth.

- *Increasing the quality of business transfers:*
  Here, the concern of government is the post-transfer performance of the enterprise. On the argument that a badly executed transfer can result in a business that performs at levels below pre-transfer levels, with resulting losses in jobs and community welfare benefits, government strives to foster higher quality transfers and ties incentives to post-transfer performance. Transfers that result in enhanced performance can create new employment opportunities and related social benefits.

Clearly these roles can overlap. Unfortunately, not enough evidence exists concerning the relative ability of government policy to affect any of these results. In fact, given its multiplicity of goals and constituencies, government can sometimes create unintended consequences with its actions. Hence, a policy to foster transfers may simply mean more businesses are absorbed by others and most of the original firm's assets are disposed of. Alternatively, policies that foster business buy-outs have the potential to undermine family business succession. Yet, as we shall discuss, there are specific roles that public policy might serve.

5.8 Returning to the demand side: The needs of prospective acquirers

Clarifying the role of public policy requires that we return to the question of supply and demand. It would seem worthwhile to distinguish policies and initiatives aimed at enhancing supply (i.e., the readiness and valuation of the business being transferred) versus those aimed at enhancing demand (i.e., the number of qualified buyers or heirs). A perusal of the proposed policy initiatives suggests that much of the attention is being devoted to the supply side (e.g., concerns that entrepreneurs are not properly prepared to sell, or have not properly prepared their venture).

It is my view that these types of efforts are likely to have little effect. It simply is not clear that government can enhance the value of a business, that it can better prepare a business for transition given the idiosyncrasies of owner-entrepreneurs and their contexts, or that it can change the number of viable transfers that do not happen because the venture exits the market. If anything, many proposed government initiatives are likely to have greater impact on those businesses having little value in transfer - businesses that should be encouraged to die a natural death. Rather, other than its role in enhancing the availability of information to business owners regarding prospective buyers, policy efforts on the supply side should concentrate on removing existing government constraints on smooth, efficient transfers.

Instead, the greatest amount of effort should be on the demand side. By focusing on demand as opposed to supply, the presence of more buyers with enhanced ability to buy (and more heirs with ability to lead) will drive up prices of businesses to a higher level than they otherwise might be, benefiting sellers. Further, greater demand will find buyers seeking out ventures that might otherwise simply be terminated. Of course, as some of these buyers are individuals who might otherwise have started ventures, the rate of acquisitions can come at the expense of new start up rates.

Efforts that focus on the demand-side, some of which are in play in EU countries, can take many forms. Priorities include assistance with financing of venture purchases, government guarantees for some proportion of bank loans for purchases, tax credits if one finances a purchase that are equal to the interest being paid, government contracts that favor acquired businesses during the first two years of new ownership, electronic venture exchanges that comprehensively and rapidly convey data on ventures that may be available, and training programs on the acquisition process, among others. In a separate vein, given that starting a venture and selling it after a few years is less common in the Netherlands, entrepreneurs may be less aware of the real value of a given enterprise. As such, buyers can also use assistance with valuations and will benefit from access to historical market valuations of previously transferred companies by industry and size.

If initiatives are developed to grow the demand side, then again it becomes important to segment the market of potential buyers or acquirers (e.g., individuals vs. organizations). Policymakers may want to emphasize increasing the numbers of certain types of buyers (e.g., minorities, domestic over foreign citizens, those with relevant industry experience). Further the potential for growth in numbers of buyers will vary by segment, as will the types of policy initiatives to which they are likely to respond.

5.9 What we don't know does matter

At the same time, it can be argued finely-tuned and well-targeted policy decisions, from which specific results can be tracked, will become more viable as we learn more. Transfers represent a complex phenomenon where much more is not known than is known. There is a pressing need for richer statistical insights into the demographics and underlying nature of exits and transfers within the Netherlands, especially in terms of the characteristics surrounding family versus non-family business transfers. Beyond this, Exhibit 5.3 highlights some practical research questions where insights might lead policymakers in very different directions.

Exhibit 5.3 Key Research Questions to Guide Public Policymakers in Addressing Transfer Issues

- Are there natural rates of business transfer, failure, and exit and are these rates changing as the national and global economic context evolves? Especially important is the number of businesses that do not transfer and yet have growth potential.
- Earlier, five methods were suggested for segmenting the population of transfers. Post-transfer performance trends that distinguish among these different segments should be established.
- Clarification should be provided of the societal impacts of higher or lower numbers of business transfers, of transfers in different sectors of the economy, and of the economic impact of the failure of viable businesses to transfer.
- Empirical evidence is needed regarding the impact of government policies on transfers. Specifically, the relative impact of removing existing government-imposed tax and regulatory obstacles as opposed to creating new initiatives intended to assist or facilitate the transfer process should be examined. A further distinction should be made in assessing the impact of policies and programs directed at the supply-side versus the demand-side of the transfer equation.
- Further research should establish the roles of age, value, entrepreneurial orientation, and managerial experience in producing successful transfers. Do success rates vary more based on a) age of company being transferred, b) value of the company being transferred, c) entrepreneurial orientation of the company being transferred, d) age of the company or entrepreneur that is taking over the transferred company, e) entrepreneurial orientation of the individuals or organization taking over the transferred company, or f) relevant experience of management in the post-transfer company? What are the interaction effects?

In addition, a stronger knowledge foundation can guide and be guided by the development of a theory of transfer activity. A logical theory that both explains and predicts transfers, post-transfer performance, and the larger economic and social impacts of these transfers will be invaluable to policymakers and others. Such theory can help us to properly prioritize the factors that influence transfers and better delineate the role of public policy.

5.10 Conclusions

As in many industrialized nations, entrepreneurship poses a significant challenge within the Netherlands. The Global Entrepreneurship Monitor (Acs, et al., 2005) consistently shows the Netherlands to have one of the lower scores among countries participating in the study, even as it has one of the higher scores among EU countries. One can point to any number of historical, structural, regulatory and economic factors to explain the lack of a more vibrant, entrepreneurship-based economy. Ultimately, though, it is a question of the attractiveness within the Netherlands of business ownership as a life pursuit, and a question of the supply of entrepreneurial (as opposed to managerial) ability in society. These are issues that are captured in the fabric or culture of society itself.

It is beyond the scope of this paper to critique or make normative suggestions regarding the culture of the Netherlands, or how it might (or might not) be changed. However, both Lois Stevenson and David Storey provide valuable and contrasting perspectives on this issue in an earlier version (2002) of the *Entrepreneurship in the Netherlands* series. Quite simply, the need is not for more transfers or start-ups per se. Innovation and growth must be celebrated. The needs are for a greater number of firms with entrepreneurial as opposed to small business orientations, and a smooth and efficient marketplace that facilitates the transfer of those firms either within (transfer within the family or to current employees) or without (transfer to external entrepreneurs and corporations). Hence there must be a culture that prizes growth, change, risk, and innovation.
As Reeb (2005) has noted "the basis of a firm's value is its vigor as a going concern". Vigor is reflected not so much in performance as in the entrepreneurial orientation of the firm. If we consider the structural context of the Dutch economy, firms with high entrepreneurial orientation occupy the vast yet relatively lonely middle ground that lies between the disproportionate numbers of lifestyle firms and large conglomerates. This middle ground is not limited to technology-based firms and those who operate in business-to-business markets. It is this middle ground that should be the primary recipient of any enlightened public policy initiatives.

In an earlier chapter of this volume, Haane provided a very useful overview of ways in which government can facilitate the transfer process. As she suggests, removing government-imposed obstacles can be a greater challenge than creating new sorts of incentives. If we consider the range of options that she discusses, the various initiatives can be grouped into three categories. The first of these is internal to the enterprise and the second and third concern factors external to the enterprise.

a. Internal - how to enhance the business itself in ways that heighten the likelihood of success transfer.
b. External - how to remove obstacles from efficient transfer processes.
c. External - how to create or improve infrastructure that actively supports transfers.

Based on the patterns in EU country implementation of the various recommendations from the European Commission reports regarding transfers, it would seem the greatest attention is being given to internally-focused initiatives. While external initiatives receive some consideration, these efforts do not typically reflect bold changes that go the heart of the infrastructure, the bureaucracy, and other anti-growth and anti-innovation constraints.

It is important that the policies that are developed, and those that have been implemented, be more than 'tinkering at the edge'. Policymakers should focus less on incrementally modifying some of the rules of the game when the problem may be the game itself. As a case in point, far too much emphasis is being placed on planning. Succession planning does not provide the enormous benefits implied by the many observers who seem to think, if firms would just plan for it, either more transfers will happen, they will happen more smoothly, and/or they will result in a higher performing business. The presence of a well-formulated succession plan, and the commitment by the entrepreneur to follow the plan, will not dramatically affect the aggregate transfer situation. Moreover, as Picard (2004) has noted, the very nature of small business and entrepreneurship is a key constraint when it comes to succession and transfer planning.

In the final analysis, I would encourage a public policy approach that is two-pronged. On the one hand, policies should focus on increasing the supply of highly entrepreneurial start-ups. The importance of a concentrated focus on innovative, growth-seeking firms can be found in some of the initiatives in the Action Programme put forward by the Dutch Ministry on Economic Affairs. On the other hand, policies should concentrate on developing the demand for transferred businesses. With regard to the former, a greater supply of growth-oriented ventures will not only mean ventures that more easily transfer down the road, but it means a bigger pool of experienced entrepreneurs. The evidence is pretty clear that experienced entrepreneurs frequently start subsequent ventures and often acquire ventures. With regard to the latter policy focus, elimination of all regulatory and tax disincentives and creation supportive infrastructure (particularly as relates to financing) that are designed to intensify demand should take precedence over supply-side imperatives.

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