



*Briefing: Business
Succession in Wales*

May 2020



Contents

| | |
|--|-----------|
| Business succession in Wales | 3 |
| What are the main business succession modes? | 4 |
| What do we know about business succession Wales? | 5 |
| What is the process of business succession? | 7 |
| What are the factors determining Welsh business succession rates? | 8 |
| Understanding trends in Welsh business succession | 11 |

Nikos Kapitsinis, Max Munday and Annette Roberts

Welsh Economy Research Unit, Cardiff Business School
mundaymc@cf.ac.uk

For further information or to submit feedback and research proposals please email: EconomicIntelligence@developmentbank.wales

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Economic Intelligence Wales Limited, Unit J Yale Business Village, Ellice Way, Wrexham, Wales, LL13 7YL, 11001584.

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Business succession in Wales

Business succession in Wales has been described as a 'ticking time-bomb'.¹ Economic Intelligence Wales is launching a project to look deeper into this issue and with this briefing giving an initial overview as a prelude to future research in 2020.

Change in ownership (and control) is a critical event in the evolution of firms. In SMEs in particular owners and managers face difficulties planning for succession, with the process involving handover of some or all business assets and decision-making power, but also the transfer of skills and contacts. This process can change business strategy and relationships, bringing organisational transformation. The previous (November 2019) Economic Intelligence Wales report on Medium Sized Firms and the Welsh Business Structure has already revealed the importance of interventions to support small firm progression to medium-sized firms, and to encourage progression among Welsh medium-sized firms.

In Wales, as in other UK regions, policy debate has often focused on new business promotion, and the growth of established firms, as opposed to ownership succession. The importance of ERDF and ESF funds in Wales over the previous two decades has created rich data sets around the evaluation and monitoring of new starts, the resulting employment creation, and business growth. This has resulted in some rich data sets but perhaps has taken away from in-depth analysis of ownership succession and progression issues.

¹ See Wavehill (2017) How Dangerous is the Business Succession Time Bomb? – SME succession planning support in Wales. Ceredigion: Wavehill.

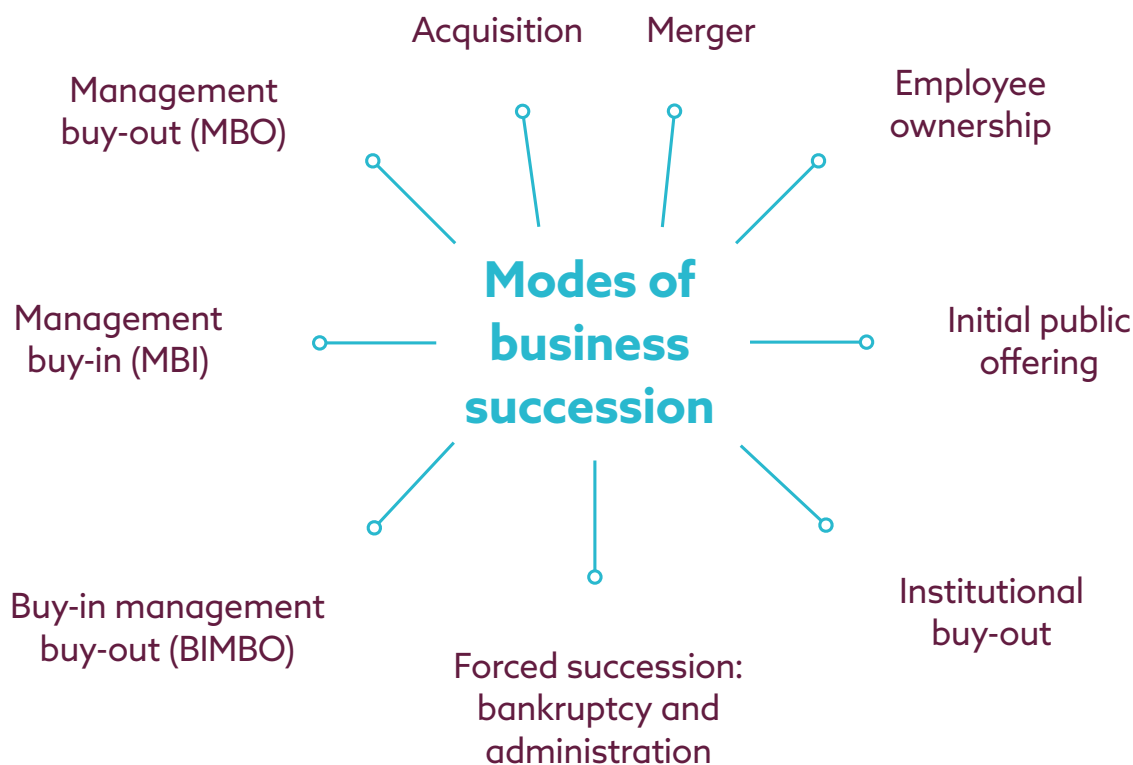
What are the main business succession modes?

Modes of business succession are varied and are summarised in Figure 1. For SMEs in particular, succession is often understood in terms of family-owned firm succession or takeover activity involving external firms.

However, succession can involve many different types of activity, with processes not always planned but forced by factors such as bankruptcy or administration. Ownership change might not always be the same as succession. Commonly used data sources inevitably focus on events in terms of change in underlying ownership or structure. However, there may be

an element of succession in terms of control of the firm's operation without a dilution of owner capital stake and/or firms being 'gifted' to new owners or family members. There may be little visibility of this in available firm-level data. Even in these cases of more 'silent' succession, planning the process is important.

Figure 1.
Modes of business succession



What do we know about business succession Wales?

Examining business succession is made difficult because much existing data only covers a small proportion of the business succession events occurring in the economy. It is likely that succession events in small and family owned enterprises simply fall under the radar of official statistical data collection.

UK figures from the ONS Small Business Survey show that in 2018, 4% of surveyed SMEs saw an ownership structure change, while the 2015 figure was 9%. Among SMEs it is firms of larger

employment size that are more likely to see a change in ownership structure in a given year. The ONS Small Business Survey also reveals variation in business transfer rates by sector. In 2018, for example, professional services (8%) and manufacturing (7%) had the highest SME succession rates in respect of the underlying SME population, with health/social work and arts having the lowest (1%).

Among the devolved regions, Wales appears to have relatively low business transfer rates (see Figure 2). The figure shows strong differences between the years, but in 2012, 2015 and 2016, Wales either had the lowest or equal lowest ownership structure change rate.

Figure 2.

Surveyed UK SMEs whose ownership structure has changed by year and devolved administration and country (%)



| | 2012 | 2015 | 2016 | 2017 | 2018 |
|-----------|------|------|------|------|------|
| Wales | 6 | 5 | 2 | na | 4 |
| Scotland | 8 | 8 | 3 | 3 | 3 |
| N.Ireland | 6 | 5 | 6 | 2 | 4 |
| England | 7 | 9 | 4 | 3 | 3 |

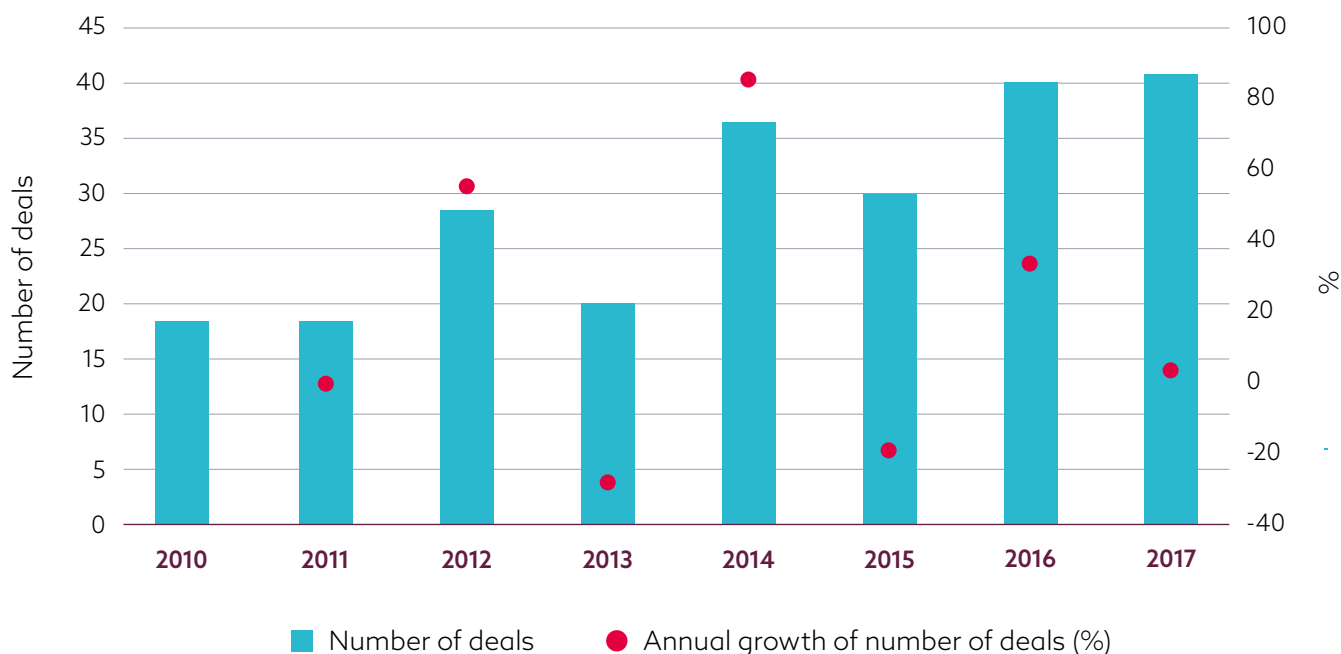
Source: ONS Small Business Survey

In 2017 Wavehill Consulting indicated that just 7% of the Welsh businesses surveyed by them had planned for ownership transition or the closure of the company in the following three years, while 16% of firms had considered transfer planning in the longer term². In the survey, **77% of the Welsh companies had not planned for business succession at all.**

Figure 3 reveals information from the Zephyr database in respect of the number of SME ownership transfers in Wales 2010-2017. This shows some increase through time in ownership transfers with the number of deals increasing for three consecutive years, from 2015 to 2017.

What do we know about business succession Wales?

Figure 3.
SME transfers by year, Wales



Source: Zephyr

According to Zephyr data, 70% of SME ownership changes in Wales result from acquisition. Management buy-out/buy-ins account for 23% of deals (and almost exclusively buy-outs here). The remainder was accounted for by smaller numbers of initial public offering, mergers and then institutional public offerings. According to Zephyr the vast majority of Welsh SME deals in the period 2010-17 reported on their database had a deal value in the range £1m-£20m.

The location of the acquiring company can have important implications for the further evolution of the SME, both in terms of control locus and potential displacement of activity elsewhere.

Wales is a regional economy where many of its business head offices are located outside the region. The branch plant economy describes the tendency of regional economies being dependent on economic activity whose production units are based in the region but is headquartered outside of the region.³

Data from Zephyr reveals that in the period 2010-17, 53% of SME ownership transfer cases involved Welsh SMEs being taken over by either rest of UK or overseas firms. This implies that the succession of SMEs in Wales results in the majority of ownership leaving the region.

² Wavehill (2017) How Dangerous is the Business Succession Time Bomb? – SME succession planning support in Wales. Ceredigion: Wavehill.

³ Phelps, N. (2016) Branch Plant Economy. In: D. Richardson, N. Castree, M. Goodchild, A. Kobayashi, W. Liu and R. Marston, eds. International Encyclopaedia of Geography: People, the Earth, Environment and Technology, Chichester: Wiley-Blackwell.

What is the process of business succession?

Business succession is a process needing careful planning. In a transfer of ownership/control there are issues of selecting a successor and the complex financial and legal aspects related to the transfer.

In many cases of family business succession, a process can begin with growing involvement of the successor, accompanied by a gradual reduction in predecessor involvement until the 'real' transfer of control occurs.⁴ Family firms make up an important constituent of businesses in many locations in the Welsh economy and much of the succession literature focuses on the difficulties they face.⁵ However, similar issues are typically present in many succession processes irrespective of firm size or ownership.

Change management and having a clear pathway to the change of ownership with a plan for managing the change is essential. **Lack of planning** is identified as the most common factor for the failure of a business post-succession. For smaller firms and family enterprises,⁶ poor planning capability has been linked to founder

features (attachment to the company, fear of retirement) and the underlying motivation for new owners. When planning for succession is initiated early with the next generation, the procedure has been shown to be smoother and more efficient.⁷

In the case of Wales, understanding the time profiles of succession processes is critical for planning interventions, and with better information here allowing organisations such as Development Bank of Wales to optimise when it is best to become involved in the process. Indeed, the selection of appropriate finance tools through which to finance different modes of succession can have a marked effect on the success or otherwise of the business transition process.

The **business transfer experience** can affect post-succession business prospects. Acquirer lack of acquisition experience may imply higher costs and restrict procedures for the integration of target company's resources, that could improve the performance of the company post-succession. On these grounds, prior experience with business transfers is likely to imply success in later acquisitions.⁸

⁴ Cabrera-Suárez, K., De Saá-Pérez, P., and García-Almeida, D. (2001) The Succession Process from a Resource- and Knowledge-Based View of the Family Firm. *Family Business Review* 14, 37-48.

⁵ Grant Thornton (2015) Keeping it in the family. Available from: <https://www.grantthornton.global/en/insights/growthiq/keeping-it-in-the-family/>

⁶ Ibrahim, A., Soufani, K., and Lam, J. (2001) A Study of Succession in a Family Firm. *Family Business Review* 14, 245-258.

⁷ Murzina, J., and Tonyшева, L. (2016) Succession of Business in Russia: Motives for Owners' Business Transfer under the Conditions of Economic Instability. *Indian Journal of Science and Technology* 9 (27), 1-16.

⁸ Bruton, G., Oviatt, B., and White, M. (1994) Performance of acquisitions of distressed firms. *Academy of Management Journal* 37, 972-989.

What are the factors determining Welsh business succession rates?

There has been a paucity of work in relation to factors determining business succession rates in Wales and how they vary according to industry and initial form of ownership. There are also a series of cultural and behavioural issues that can affect succession activity across different geographies. Critically, many owners in Wales and elsewhere, even in larger SMEs, rarely consider processes of succession.⁹

Firm size can affect business succession rates. Larger enterprises are more able to bear the high costs in searching for new business opportunities or overcome capital constraints that preclude the development of new processes and products.¹⁰ But much of the Wales' business population is made up of micro and small firms. For these firms cost constraints force them to be more reactive to succession opportunities. It is likely that the **size and sectoral structure of Welsh firms** could impact on succession rates although research is clearly required to identify relationships more precisely.

Changes in the **structural make-up** of Wales and the changing balance between manufacturing, services, and non-market activity will exert some influence on regional rates of business succession and ownership change. Succession rates will also connect through to Welsh SME productivity levels. Efficient succession processes mean that technology is better used leading to productivity improvements and better use of scarce resources.

For micro and small firms, **owner features** affect succession planning and outcomes. In family firms particularly, the age of the firm and owner are important considerations. Family-owned companies tend to record lower propensities for ownership change with this related to the emotional attachment of owners to their enterprises, and lower entrepreneurial ambitions,¹¹ with family **business owners not trusting others** to run their companies.

According to Bureau van Dijk FAME figures, around 11% of SME directors are close to 'retirement age' (i.e. defined here as between 60-70 years of age) in around 81,500 Welsh SMEs where data is available. This sort of information reveals the likelihood of a succession 'event', even if this is not identical to a change in ownership of the firm involved. While age might be one indicator of future trends in succession rates, it could paradoxically be an indicator of the fear of retirement, resulting in a reluctance to either plan or execute succession. This mindset has impacts on appetite for external finance. Moreover, entrepreneurs could have unrealistic expectations on business value and investor willingness to pay. In these spaces there is a role for policy interventions to breakdown asymmetric information problems.

11%

SME directors are close to 'retirement age'

⁹ Grant Thornton, op. cit.

¹⁰ Kumar, M. (1985) Growth, Acquisition Activity and Firm Size: Evidence from the United Kingdom. The Journal of Industrial Economics 33, 327-338.

¹¹ Wasserman, N. (2003) Founder-CEO succession and the paradox of entrepreneurial success. Organization Science 14, 149-172.

What are the factors determining Welsh business succession rates?

Trends in business succession can be influenced by the strengths of markets and economic conditions. For example, some entrepreneurs choose to sell on firms when their **performance is strong – a pattern often seen in high technology firms**. However, other business owners might sell in the expectation of business decline in a **necessity-driven business succession**.¹² For example, management buy-outs might be executed by business owners when firms have poorer economic performance,¹³ uncertain outlook, or are deemed to be financially vulnerable.¹⁴

The **supply side of finance tools** can also affect succession patterns.¹⁵ Finance tools for business transfers include private equity, bank loans, seller financing, and mezzanine finance. Information from the ZEPHYR database suggests that in respect of SME ownership transfers, that new bank facilities were the dominant type of finance used in over half of Welsh cases in the 2010-17 period, followed by private equity in around 40% of cases.

While the private sector is closely involved in providing finance and support for succession, particularly through the banks, it is undoubtedly the case that Welsh Government and Business Wales interventions have and will affect the process of business succession in Wales. Notwithstanding it has been shown that the explicit provision of SME succession planning support is limited when compared to resources focused on start-ups.¹⁶

However, more encouraging in this funding respect is that the Development Bank of Wales has worked to establish a 'Wales Management Succession Fund'. Since 2008, the Development Bank has made 32 loan and equity management succession investments above £0.5 million.

These represent a total direct investment of £39 million with private sector leverage of £26 million, resulting in 1,770 jobs created or safeguarded.¹⁷

Currently there is very little information available for Wales on whether the availability of, and information on suitable finance tools constitutes a barrier to business succession or not. More case-based work is needed to identify whether existing finance provision is fit for purpose in dealing with selected business succession issues.

£39 million
total direct investment

£26 million
private sector leverage

1,770
jobs created or safeguarded

¹² Song, S., and Zeng, Y. (2015) Performance, Partner Relationship, and Ownership Change in International Joint Ventures: The Case of Korean Firms in Asia. *Journal of Asia-Pacific Business* 16, 171-190.

¹³ Peel, M. (1995) The Impact of Corporate Restructuring: Mergers, Divestments and MBOs. *Long Range Planning* 28, 92-101.

¹⁴ Cummins, D., and Xie, X. (2008) Mergers and acquisitions in the US property-liability insurance industry: Productivity and efficiency effects. *Journal of Banking & Finance* 32, 30-55.

¹⁵ Peel, M. (1995) op cit.

¹⁶ Wavehill, op. cit.

¹⁷ Not all these investments were made through the Wales Management Succession Fund.

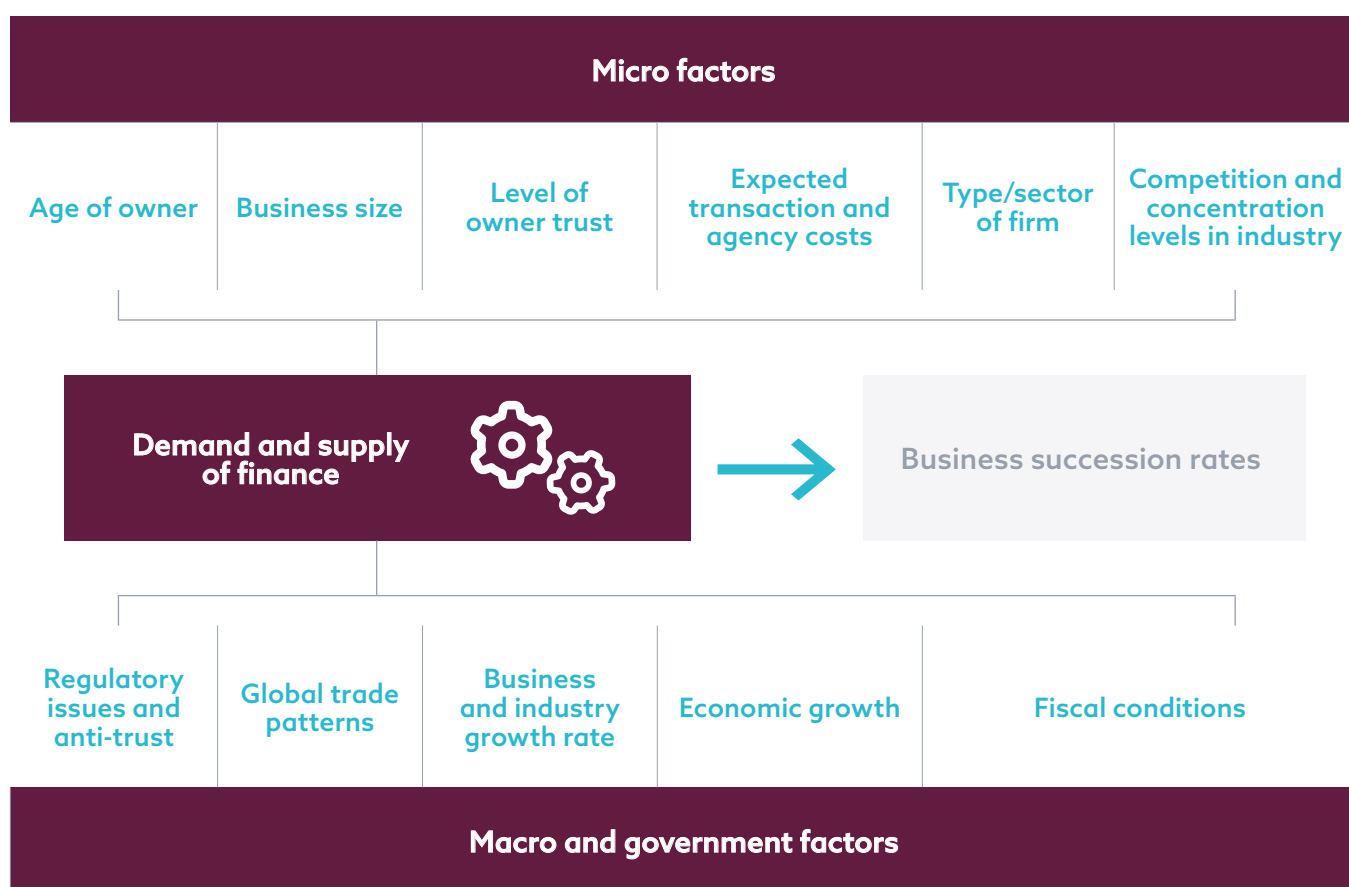
What are the factors determining Welsh business succession rates?

In summary, change in ownership is part of business evolution. The factors affecting business succession rates are complex (Figure 4), and the factors determining success or failure of the succession process embrace factors both before and after the 'change' event. A unifying theme in research is around careful planning of the whole succession process. Within this planning process, getting the financing right is important

for small and large firms alike. In Wales there is a real challenge to better understand how demands for finance for succession are framed and how organisations such as Development Bank of Wales can position support at the right time in the whole succession process (ex-ante and ex-post) to ensure smooth and efficient changes of ownership.

Figure 4.

Micro and macro factors affecting business succession rates



Understanding trends in Welsh business succession

It is difficult to escape the conclusion that there are information gaps about processes of business succession in Wales, and how far it is possible to generalise on research from elsewhere. There are a series of interlinked issues in terms of the data available and subsequent analysis. Much of the available data focuses on more easily identifiable changes in ownership of firms, particularly where there is a complete change. There are real problems in terms of coverage, and this particularly in respect of micro and small firms which are the largest business demographic in Wales.

Policy development and resource targeting needs to occur in the context of better quality information on business and SME needs, with limited knowledge on the scale of any succession problems in the regional economy.

Further more detailed research on this issue will be published by Economic Intelligence Wales later this year, seeking to address data issues of business succession in Welsh SMEs. Among the questions that research will seek to address are:

- What are the specific problems in Wales in terms of business planning for succession?
- Does Welsh business succession activity vary across industry sector, firm size, and geography?
- Are there additional research issues around culture, behaviour, and gender that need to be addressed in the business succession debate?
- Why does Wales appear to have relatively low business transfer rates, and what are likely consequences of this?
- Is lack of succession planning a common factor for the failure or low growth of Welsh firms?
- Is the availability of, and information on, suitable finance tools a barrier to business succession in Wales?



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