

Growing Challenge – Increasing Interest in Takeovers

DIHK-Report on Corporate Succession in 2016

Figures and Estimates of the CCI Organisation on the Generational Change in German Companies



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Industrie- und Handelskammertag

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DIHK-Report on Corporate Succession in 2016 – Highlights

Growing challenge	In 2015 the Chambers of Commerce and Industry (CCIs) provided advice to 6,483 senior entrepreneurs, corresponding to nine percent more than the previous year and even 60 per cent more than five years ago. One driver of this is demographic developments. More and more entrepreneurs are reaching retirement age. Furthermore, the increasingly self-assured "Generation Y" often goes its own way – an "automatic mechanism" whereby the company is taken over by the son or daughter is becoming less and less common. As a result, more and more entrepreneurs are looking outside the family in their search for a suitable successor.
Significantly more potential purchasers	It is encouraging that the number of potential purchasers interested in taking over other companies has also increased – at almost 20 per cent even more than the number of senior entrepreneurs. 5,013 people who stated that they could imagine taking over an existing company consulted their Chamber of Commerce and Industry. As a result, the deficit of potential successors that has existed throughout Germany over the last three years has decreased somewhat.
Information services bearing fruit	All in all, 21,684 company owners and people interested in taking over such companies contacted their CCI in 2015 to enquire about business succession – more than at any time in the last seven years. Besides demographic developments, the extensive information services of the CCIs and other institutions and of politics are clearly bearing fruit.
Sticking point: the purchase price	According to the CCIs, 44 per cent of company owners are asking for a purchase price which is too high when measured against the market environment. Senior entrepreneurs often include all of the effort that they have put into their life work when calculating the purchase price, while those wishing to take over the company have a somewhat more sober view of the market potential of such companies. Furthermore, CCIs often identify an investment backlog in the case of companies searching for a successor, which in the digital age in particular – with its faster and faster innovation cycles – can have a negative effect on the value of the company. On the other hand, 40 per cent of those interested in taking over existing companies underestimate the requirements that apply to the acquisition of an existing business. 43 per cent report financing difficulties in spite of the current favourable financing environment.
Things remain tight – in spite of increasing easing of pressure	In manufacturing industry, which is home to many small and medium-sized "hidden champions", CCI advisers see an average of five company owners for one person interested in taking over such companies. In the retail, hospitality and transport sectors, the CCIs encounter twice as many senior entrepreneurs as potential purchasers.
Alarming number of companies without a first aid kit	In 2015, 72 per cent of entrepreneurs did not have the documents required for a smooth transfer at hand for a person of trust.
More women interested in takeovers	22 percent of all prospective successors in 2015 were female, compared to the figure of 15 per cent five years previously.

Based on the practical experience of the CCIs of more than 21,000 interviews and contacts annually with senior entrepreneurs and prospective successors, the German Chamber of Commerce and Industry (DIHK) is addressing the following recommendations to politicians which would in particular make business succession easier:

Inheritance tax – agreement at last, but tax relief remains on the agenda

With the agreement on inheritance tax, the transfer to the next generation will become more expensive for many companies. Before the reform, a good fifth of those transferring their business considered inheritance tax to be a burden. It is to be hoped that this proportion does not increase after the reform. Nevertheless: with the reform, family businesses now finally have legal certainty – not least with respect to investments, recruitment and business succession. In addition, the envisaged method of determining the value of companies is now more realistic than the one under discussion just a few months ago. However, reducing taxes on small and medium-sized companies as well as family businesses remains on the agenda. One of the items which is urgently required is contemporary depreciation rules.

Expanding the SME correction factor

The favourable financing environment is currently making it easier for business successors to finance the purchase price. However, with the increasing regulatory requirements relating to the equity and liquidity base (Basel III), it has become more difficult for financial institutions to provide loans in recent years. In July 2016, the European Commission announced that it would be retaining the SME factor (correction factor for small and medium-sized enterprises) that it had been testing since 2014 in order not to make the granting of SME loans more difficult for the banks. The discussions between the DIHK and other business organisations with politicians in Berlin and Brussels contributed towards this. Furthermore – according to the EU Commission – the restriction on the credit volume should be lifted. A reliable legal framework for the SME factor would provide the financial institutions with planning security and thereby improve access to finance. This would also assist with the financing of corporate successions if, for example, the current owner assisted the successor with a loan. Moreover, such a rule could partially offset the negative impacts of the intensifying regulation of the banking market in the form of increasing capital requirements (Basel IV) and the associated access to finance on the part of SMEs.

Improving access to venture capital

With the financing of business successions with venture capital, the CCIs also see improvements compared to last year. Here too, the current financing environment reflects the following: The low level of interest rates means that fixed income investments are currently less attractive. For this reason, investors are increasingly looking for attractive corporate investments. However, politics should take precautions for the period when interest rates rise again. Recently, politics and the KfW expanded the supply of state equity. Politics should now reduce the tax obstacles for private investors in order to give additional thrust to the venture capital financing in Germany. The draft law on the amendment to the shell company acquisition regulations with the facilitation of losses carried forward in the newly planned Section 8d of the Corporation Tax Act (KStG) is an important step in this. It should now be adjusted to ensure that it is in line with practical requirements and then rapidly implemented. For example, according to the cabinet paper, the business operations of the joint-stock company would have to have remained unchanged in the last three years. Furthermore, the corporation is not allowed to discontinue or suspend its business operations or take up additional business operations. But it

is often corporate successions in particular which reveal the need to carry out business management changes and modify existing or develop new business models.

"Start-up and follow-up check" for rules and laws

The First Bureaucracy Relief Act has exempted successors from obligations to supply information by clarifying aspects of statistics laws. However, the broad effect is small – around 1,000 companies will benefit from the reduced bureaucracy, which in view of the approximately 27,000 companies which are lined up to be transferred to a new owner every year represents only a small proportion¹. Existing rules should be systematically reviewed in terms of their potential for providing relief with respect to new business start-ups and business successions. Because a reduction in bureaucracy makes the "entrepreneurship" option more attractive – and therefore also the continuation of existing businesses. For this reason, the Bundestag should seize the opportunity within the framework of the Second Bureaucracy Relief Act to provide palpable relief across the board to small and medium-sized businesses and increase the limit for low-value assets – which has applied for the last 50 years – from 410 euros to 1,000 euros.

Promoting business start-ups

Although the CCIs are seeing an increasing number of people who are interested in taking over an existing company, which is also due to the intensive information services provided by the CCIs, as well as other business organisations and politics, it nevertheless remains to be seen whether this will develop into a trend. Overall, the number of people interested in building up their own corporate existence has been declining for several years. In order to encourage more business start-ups, a consistent policy mix is required that consists

- firstly of a reduction in bureaucracy, for example by means of functioning one-stop shops in the regions,
- secondly of better financing conditions, particularly with private venture capital and
- thirdly an improved work-life balance, for example the right to a place at an all-day school.

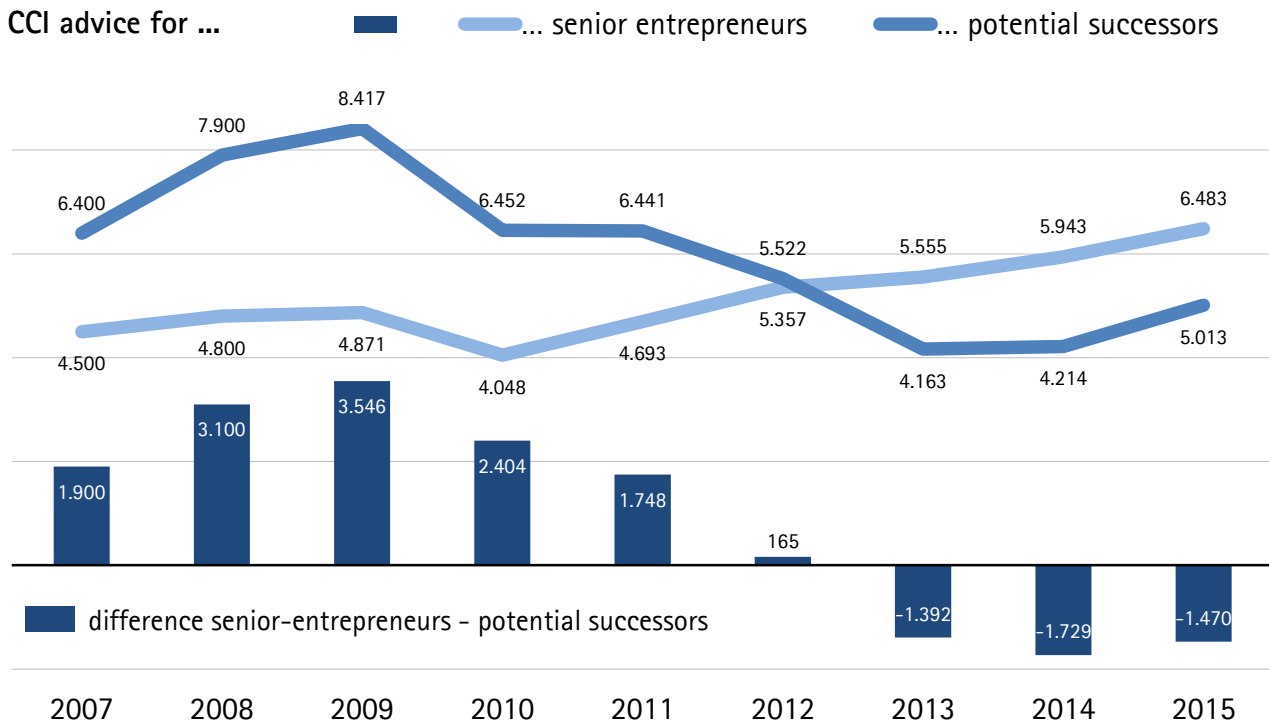
Important starting points for a forward-looking policy governing business start-ups are offered by the DIHK Founders Report² and the study "Entrepreneurship – The Key to Tomorrow's Prosperity", which the DIHK has published together with 17 other business organisations under the Joint Committee of German Associations in Trade and Industry³.

¹ Corporate successions in Germany from 2014 to 2018, Institute for SME Research in Bonn: Facts and Figures no. 11, Bonn 2013.

² Interest in founding new companies drops to an all-time low, DIHK Founders Report 2016, Berlin 2016 <http://www.dihk.de/themenfelder/gruendung-foerderung/unternehmensgruendung/umfragen-und-prognosen/dihk-gruenderreport> (December 13, 2016).

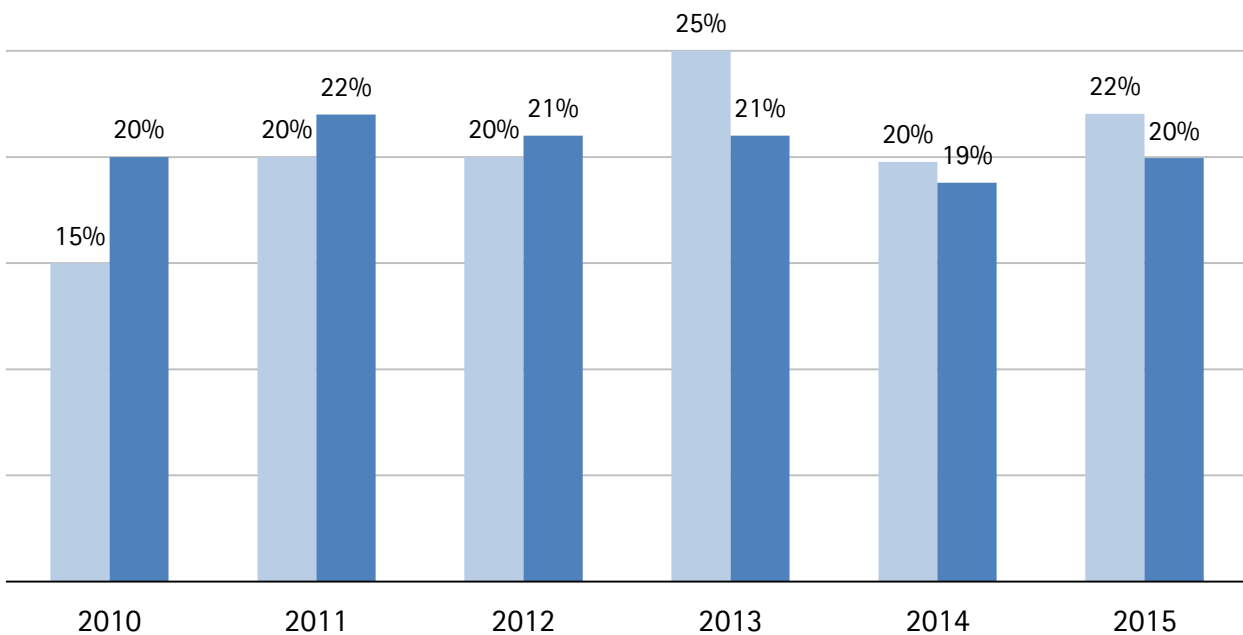
³ Entrepreneurship – The Key to Tomorrow's Prosperity, IW Consult GmbH, Cologne, 2016 <http://www.dihk.de/themenfelder/gruendung-foerderung/news?m=2016-09-26-unternehmertum> (December 13m, 2016).

Business succession: a growing challenge



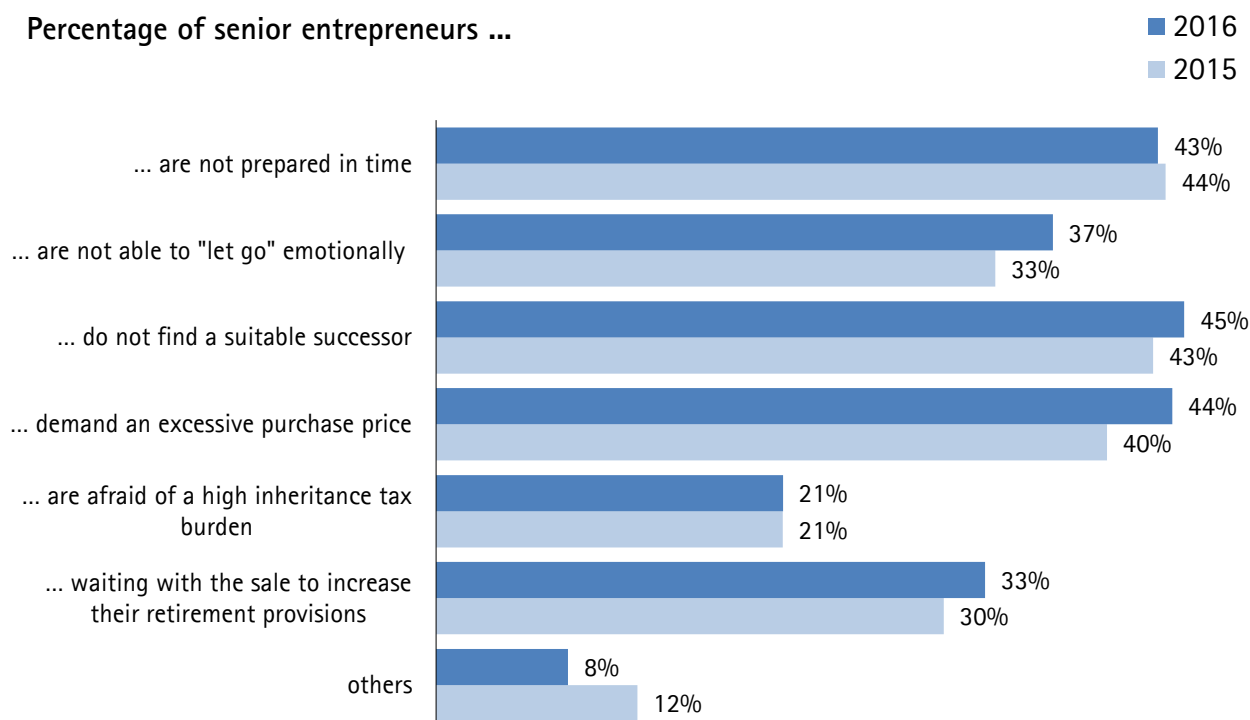
More women wanting to take over

- Share of potential female transferees of the total number of people interested in taking over existing companies
- Proportion of female owners seeking CCI succession advice

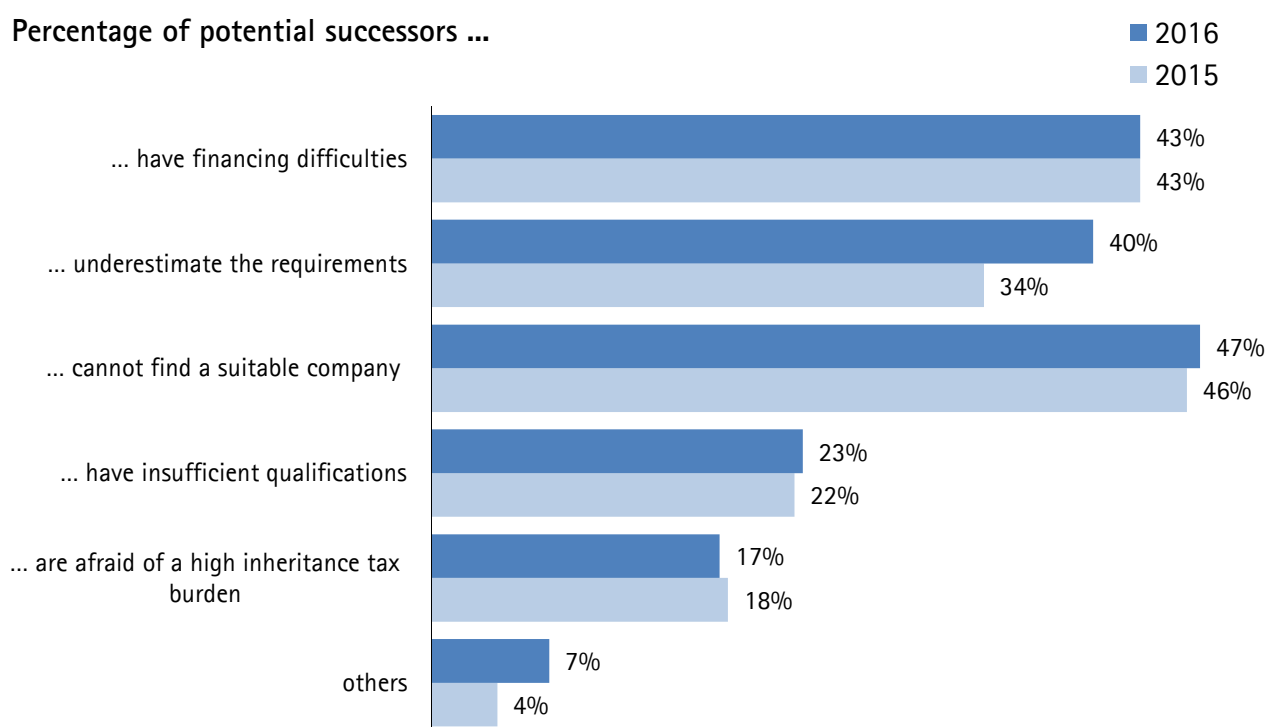


Succession negotiations: with a cool head and a passionate heart

Percentage of senior entrepreneurs ...



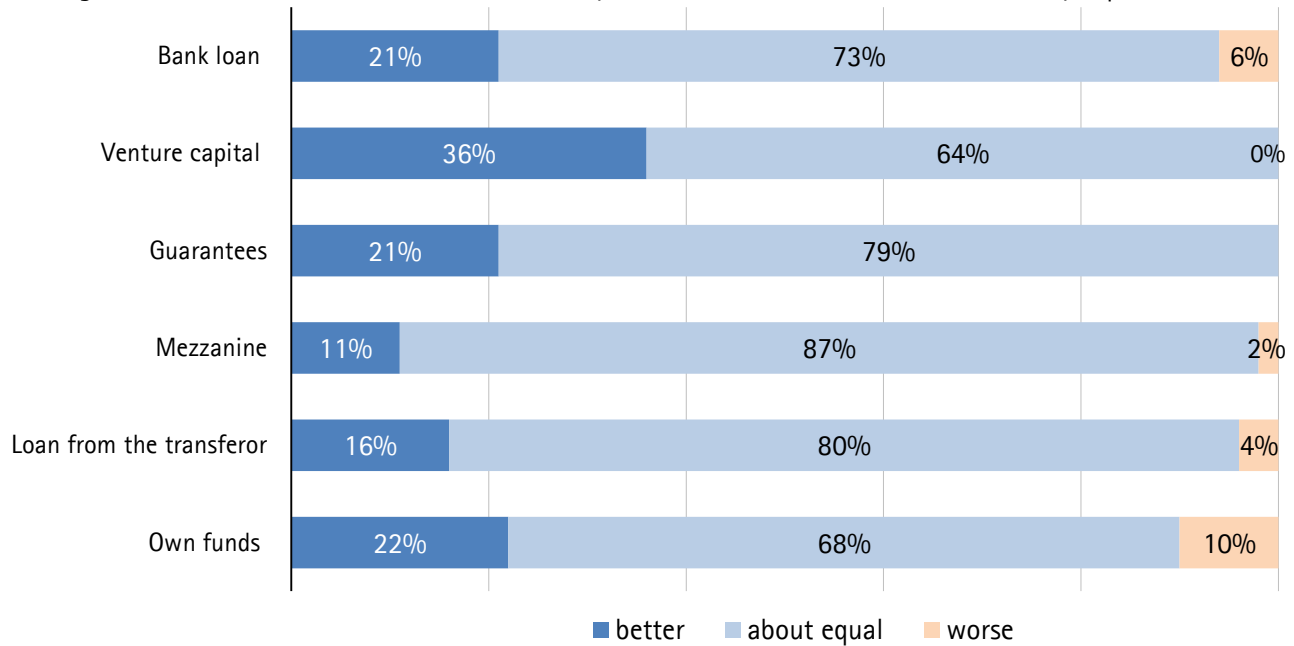
Percentage of potential successors ...



Financing: easing of pressure on the most important aspect of all

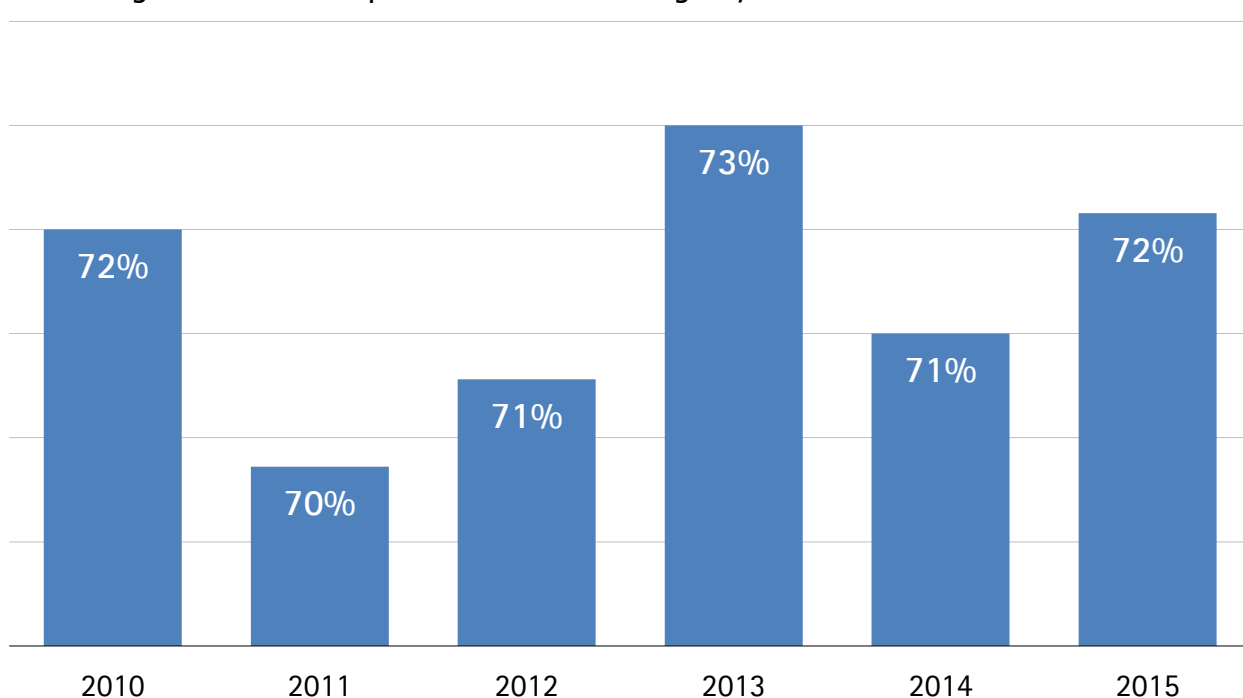
Change in financing conditions

Change over the last twelve months as observed by the Chamber of Commerce and Industry experts



Many Companies without "Emergency Kit"

Percentage of senior-entrepreneurs with no "emergency kit"



Challenge Compass Succession: Munity in the Industry

Sector-related quotients of individuals offering companies and individuals seeking companies (founders of new businesses) who request advice from a CCI

