

Work Package 5 Political Strategies and Transfer

Group of activities 5.1 Political strategies

Policy Strategy Program

Annex II Action Plan „Employees of SMEs“

Action Plan

Employees as successors / acquirers of a SME company

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Employees as successors / acquirers of a SME-company

Introduction

Employee of a company is not the first alternative coming into one's mind when searching suitable successor for the business. Those belonging to the company's management group are in many cases asked their interest, but the lower level an employee is in the hierarchy, the less probably he / she is inquired of after his /her interest in becoming as successor. Contemporary entrepreneur may have had conflicts with employees, he may underestimate their capacities or there might be suspects concerning their loyalty to the company.

On the other hand, it can be difficult for an employee to express his interests in acquiring the business. The social pressure against the colleague wishing to start a trip across the classes, i.e. from worker to capitalist, may be, depending to the country, area and culture, crushing. Employees own family may be very critic against plans like that too.

Nevertheless, many aspects are in favor of employees as considerable successors. In the next chapters, these will be discussed further.

Background

The contemporary discourse approaching employees as successors is one thread in discussion concerning employee buy-outs (EBO), which started in early 1970's, when employee ownership was on the fringes of public consciousness (Whyte & Blasi, 1984). The context of this discussion was double sided. On the one hand, the aim was to decrease the power of labor unions. On the other hand, EBOs were seen as a mean to increase the influence of workers into their work conditions. Third point of view to the EBOs was arisen in 1980's when – during the hot era of rising stock exchange rates and so called casino economy – a partnership or shared ownership was seen as a way to both protect the company from malicious acquires and to pull together the dispersed shares (Ellerman, 1993). Also financing the business and rewarding loyal employees with optional wins caused by rising rates were presented as reasons for both partial MBOs and EBOs. The golden era of EBOs started in beginning 1990s, after the collapse of soviet imperium and in the beginning of privatization. The special privatization programs were founded in many former soviet countries and in Germany, which had united, to privatize the former DDR-owned business. (Ellerman, 1993)

In Germany, the Treuhand (the German privatization agency) carried out more than 2000 MBO or MEBO privatizations in big industrial companies. In addition to these, the Treuhand had more than 20,000 further MEBOs in small retail and service firms. The Treuhand encouraged (M)EBOs as a policy instrument that supported the goals of creating SMEs (small and medium-sized enterprises) in the eastern states and of increasing private ownership in East German. (Ellerman, 1993)

In other countries, the privatizing was managed in different ways (Filatotchev;Grosfeld;Karsai;Wright;& Buck, 1996). In Poland, which was one of the first socialist countries to conduct a privatization program, privatization worked, but in the other way than was advised by free-market purists and Western advisors. Liquidation, employee/management buy-out and joint venture proved to be much faster and more successful. They could be managed, controlled and approved by local authorities, and that is why they were much less impacted by the unpredictability of Polish politics. (Ellerman, 1993).

In Hungary, there were a decentralized passively controlled program called "self- privatization", which supported many MEBOs (Ellerman, 1993). The alienation of former state-owned enterprises by the employees was supported or enabled with the use of preferential credit (Filatotchev;Grosfeld;Karsai;Wright;& Buck, 1996). Many of the programs were designed specifically for EBOs and MBOs. A special law for ESOPs or employee stock ownership plans was enacted, based to the

American and English models, and new forms of financing opportunities were developed to support MBOs and EBOs (Ellerman, 1993).

In the Russia and former Soviet States like Estonia, Latvia and Lithuania, one of the main forms of actual privatization was the lease enterprise with the option to buy—which was a type of (M)EBO (Ellerman, 1993). Another form of privatization in Russia was a voucher privatization scheme, in which state-owned enterprises were effectively "given-away" against vouchers dealt to employees and management. (Filatotchev;Grosfeld;Karsai;Wright;& Buck, 1996). Unfortunately, huge majority of people receiving the vouchers did not realize the value of piece of paper, which made it possible for some brave individuals to collect huge number of vouchers for a ridiculously low price. These individuals are now called "oligarchs". Due to the failed voucher campaign, the proportion of SMEs remained lower in Russia than in other parts of former communistic imperium.

The goal of these privatizing programs was to implement western capitalistic system (Wright;Buck;& Filatotchev, 2002). Especially supporting the birth of SMEs via employee and management buy-outs was wished to help reaching the goal. Thanks to these programs, certain countries like Poland, Hungary, Baltic countries and Russia have more experiences on Employee Buy-Outs and partial by-outs. The major part of companies born in the beginning of 1990's are now closing to their first generational transfer, and Employee Buy-Outs is one thinkable way to do this.

The potential of employees as successor / acquirer

There are many reasons why we should have a look at employees of a company and consider them as potential successor or acquirer of a business, particularly in cases where there is no willing successor or no successor at all in the owner family of the company.

Experience in the company

Employees have worked at least for a while in the company, thus, they have got acquainted with the business, the branch, their colleagues and stakeholders. Depending to their tasks, they also know at least part of the processes in the company. In best case, they have new ideas how to develop the business, organization, process or part of the process or individual product or service. By becoming owners, employees will be more motivated to impress their initiatives and ideas, as well as to take responsibility on control and supervisory functions (Wright;Buck;& Filatotchev, 2002).

Existing contacts

During their career, both in their contemporary business and working with their former employers, employees have created contacts. These contacts will help them or at least make it easier for them to take a grip on their new role. They are known, or at least they should have become known, in the branch and by all stakeholders of the business, which makes it easier for them to create contacts and become accepted as entrepreneurs. (Di Stefano, 2018).

Existing knowledge and skills

Employees, working in certain tasks, are already professionals with skills required in their profession. They know the process, routines and phases. They are also aware of how each part of the process is connected to another. Depending to their place in the organization, they may also have had an admission to the tacit knowledge. (Di Stefano, 2018) However, they most probably miss experience as entrepreneur and knowledge concerning the entrepreneurial issues. It is also worth realizing, that the entrepreneurial competences are covering, not only formal skills and knowledge but also personal properties like ability to tolerance risk and unsureness, creativity and innovativeness. These personal properties are difficult to measure and they can be taught or learned only partially.

Trust is important

It is important that former owner and his / her family trust in the successor. Almost as important as this is that all the members of new team i.e. colleagues and former superiors trust in an acquirer too. This can not be guaranteed, but it is most unlikely that owner would accept a successor who did not have this trust. If a successor has this trust, will the other employees less likely question his professional competence and

authority. However, the trust between predecessor and successor may conflict with the former employee's more professional attitude and less emotional relationship to the company than former owner family that may have very strong emotional binds to business, suppliers, customers, employees and even facilities. These emotional reactions may be reflected to long-standing employees. In such cases, the trust is emphasized. (Di Stefano, 2018).

How to support

No matter how experienced, competent and skillful the successor is, he will need many kind of support during the phases of transfer. This support may vary from reliable listener with whom a novice in entrepreneurship can discuss about fears, worries, unforeseen problems or lucky surprises, to financial support in the form of loan or guarantees needed to finance investments or as operating capital. the following chapters list examples of ways to support a new entrepreneur in his acquiring process.

Emphasizing entrepreneurial competences

When beginning the first own business a new entrepreneur may be completely unaware of competences required. He may be unsure about what to be done, and confused, even afraid of all the challenges the new role will bring along. Or having an ultra positive attitude, he may believe that he has born as a perfect entrepreneur who knows and can everything, which only proves that nobody is perfect.

One important form of support is to give beginning entrepreneurs and people with the intention of becoming an entrepreneur a change to evaluate and enhance their entrepreneurial competences, and to give them a realistic picture of their contemporary capabilities and those competencies they need to develop. (Di Stefano, 2018). One may need more knowledge in foreign language, business management or human resources whereas another may need personal training on how to control and develop personal properties, for example, how to get loose of extreme impulsiveness or excessive hesitation.

The support described above should stay on personal level, partly because the support should be tailored for each entrepreneur's personal needs, partly because the issues are very sensitive. The skills needed when running the business can be trained and taught in groups. However, the groups should be small and confidential enough to enable spontaneous change of experience as well as networking. Furthermore, arranging possibilities to practice in business management would give those interested in entrepreneurship a good opportunity to train and see whether this is their career or not.

Not only entrepreneurial skills but also the knowledge concerning the acquiring process is needed. Although this knowledge can be bought from consultants, auditors and other experts, it would be recommendable that an entrepreneur himself also knows at least the essentials of the process. This requires that these issues will be discussed during the entrepreneurial training.

The use of consultants and other specialists may be very expensive, and it would be recommendable that there were also advisors working on non-profit base. Concerning the voluntary advisors, there is one question that needs to be highlighted: The liabilities, particularly the third-party liability and insurances. Professional consulting and advising can be insured against trials and liabilities, but for consulting and advising on voluntary base it is very difficult to get insurances. This means, that the real professionals stay out of the charity work or at least the advices given remain on most universal level.

Speaking about money...

Funding is one of base pillars in starting a new business or acquiring an existing one. A major problem in transferring a business to an employee or group of employees is that they most probably do have no money to fund the transfer nor property or other securities to be used as a guarantee needed to get a funding in the form of external capital (Wright & Buck, 1992). Thus, to enable or at least to make it easier for employee to acquire a company, alternative funding sources should be established. These sources should have reasonable interest rates and guarantee requirements set on level that is significantly lower than contemporary regulation allows for traditional financing institutions.

In addition to funding, taxation is one central questions when planning the business transfer. Taxation is important for both parties of the business transfer. Taxation is often mentioned to be the major reason for

failed, delayed or cancelled business transfers, although for example in Finland, the claim “Taxation prohibits the generational transfer” is considered to be true only in 2 per cent of companies. These companies are in common big family businesses with property and capital collected for tens or even hundreds of years. However, the fear of taxes is living between the ears of entrepreneurs and prohibiting the transfers. Tax benefits for employees acquiring the company and for retiring entrepreneurs transferring their company to an employee or group of employees would be a positive sign from the government, messaging that succeeded transfers will be appreciated.

It is not so rare that an retiring entrepreneur has neglected the development of the business for years before the transfer. The product range might be outdated or processes may be obsolete, prices may be far too high or too low etc. Thus, it is probably that one of the first challenges of new entrepreneur is to update products, product lines and / or processes. Sometimes this is not enough, but the totally new products must be innovated, developed and launched. To make it possible to launch new products, both financial and marketing support might be needed.

“Successor Tinder”

Many of the retiring entrepreneurs have answered in Entrepreneur barometers and other surveys that it is difficult to find interested and capable successors whom they could accept as successor. It has also stated that even if someone inside the company were interested to acquire the company, a threshold to inform it in public is too high. There is a need for system that collects the interests of employees to have the business of their own as well as employees who already have a business of their own. This would make it easier to start discussions with persons who might be interested in becoming successors.

Recommended actions

To make it possible to find and catch the potential successors and acquirers out of the employees, as well as to support their start and continuing, the following tools are suggested to develop and launch:

- Tool for evaluating and developing the entrepreneurial competences,
- Tool for collecting the employees entrepreneurial interests (“Entrepreneurial Tinder”) inside the companies,
- Tool for evaluating the value of employee’s own knowledge and experience (“Personal assets”),
- Tool for matching the potential investors and employees interested in acquiring the company.

These tools are necessary to start and support the discussion concerning the willingness to acquire the business and capabilities required to run and develop it. In addition to these, some training programs should be developed and launched:

- Training the potential entrepreneurs in the company,
- Management training program in company for those having basic knowledge of business management and entrepreneurship and interest in becoming successor.
- Education program for those with no earlier knowledge of entrepreneurship and business management, but who have good skills and knowledge of their profession.

These training and education programs will strengthen the knowledge, skills and self-confidence of employees who are interested in entrepreneurship. Well-planned programs will also give provisions for exacting journey as an entrepreneur in the growing business.

Furthermore, it has become obvious, that voluntary or non-profit support in the form of mentoring, guidance and coaching is necessary or at least desirable help for young entrepreneurs. However, there are juridical and liability risks concerning the mentoring and counselling on voluntary base. It is recommended that following activities will be launched

- Discussion concerning the liabilities and insurances of voluntary consultants, advisors and mentors
- Discussion concerning the models of non-profit funding institutions. There are many examples of different models, but to collect experiences and to make an objective comparison between different models would be worth considering.

- Preparing the model for voluntary mentor-mentee-contracts for each country. The contract models should take into account the juridical aspects of mentoring, counselling and coaching, particularly on point of view of voluntary mentoring and counselling versus liabilities.
- Discussion concerning the possibilities to create some kind of model for nonprofit insurance company or guarantee company covering the potential liabilities caused by voluntary mentoring and advising. During the discussion, also the requirements set to voluntary mentors (Qualification, experience etc.) should be defined.

Takeovers by workforces

In the context of company successions, company sales and company crises, company takeovers can also be carried out by employees. In contrast to company takeovers by one or a few employees, employee buy-outs (EBO) involve the entire workforce, or at least the majority of the workforce, taking over the company that is providing the work. In contrast to mere employee participation and management buy-outs (MBO), EBOs are when all employees who do not belong to the top management level take over more than 50% of the voting rights of a company.

The takeover of companies by workforces is widespread in the USA within the framework of Employee Stock Ownership Plans (ESOP). Due to government support in the form of tax breaks, these are a widespread instrument for transferring the company as part of succession planning.

Cooperative models have also long been advocated as possible solutions for company takeovers. The threat of job losses and poor prospects for new jobs mean that the company providing employment must continue to operate under its own management. Such models are more common in southern France, Italy and Spain. In the Baltic Sea region, however, company takeovers by employees are rather an exception in most countries.

Co-operatives can be a promising option for business succession in the Baltic Sea region. If a family-internal succession arrangement does not come about, employee cooperatives are a promising option for continuing the business and thus preserving jobs and know-how. Moreover, employee cooperatives contribute to a fairer distribution of profits and a more democratic corporate culture. Experience also shows that employees identify more strongly with the company when they are co-owners.

The SME support institutions should make greater use of the opportunities offered by employee cooperatives for company successions. A look at other European countries also shows that a targeted support policy can be helpful here. Support models from Italy, Sweden and other European countries should be used as best practices. In addition, the tax framework for employee takeovers should be improved, in particular by significantly increasing the tax exemption limits for such participations.

Conclusion

An employee is an interesting alternative as successor or acquirer, because he knows the colleagues, products, business and branch. He is also – most probably – known in the branch, at least if he has long career behind. However, it is not easy for an employee to announce his / her candidacy for successor. To encourage and enable this, a system collecting interested people should be implemented. To support and encourage those expressing their interest, facilities to practice, train and learn the new role should be created.

For a novice as an entrepreneur, the voluntary support in the form of mentoring, advising and walking alone is welcome. However, at least in some countries it may be difficult to find mentors qualified and experienced enough, because the legal issues like liabilities and insurances are ambiguous. Clarifying these and defining minimum requirements for a mentor could encourage skillful mentors to give their support.

Takeovers by workforces and Co-operatives can be a promising option for business succession in the Baltic Sea region. The SME support institutions should make greater use of the opportunities offered by employee cooperatives for company successions. Support models from Italy, Sweden and other European countries should be used as best practices.

Transferring a business requires in most cases that an acquirer has capital enough to finish the transfer. Business needs always some amount of working capital in addition to investment capital. Beginning entrepreneur may find it difficult to get funding from open markets. Thus, there should be some non-profit funding institution granting loans and guarantees for beginning successors / acquirers.

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