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How Dangerous is the Business Succession Time Bomb? – SME succession planning support in Wales

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Executive summary

In March 2017, the Welsh Government and the Wales Co-operative Centre commissioned Wavehill to undertake research and analysis into the business succession issues facing businesses in Wales, focusing on two aspects:

- The support requirements of the Welsh SME sector with regard to generalist business support around succession planning and implementation, and
- The benefits and opportunities afforded by heightened awareness of, and support for, transforming businesses into employee ownership as part of a planned succession approach.

The Wales Co-operative Centre and the Welsh Government have identified that there are serious economic and social costs associated with business succession failure which can be avoided by planning and implementing a considered succession strategy. Elements of the Welsh economy may be particularly affected by this, because:

- It relies, to some extent, on micro-businesses of fewer than 10 employees, which are often more dependent on the founder and, therefore, more difficult to sell;
- Rural areas depend more heavily on the sustainability of key employers, who might either close or leave the area as a result of succession.

Study aims

The requirement for the study was to undertake market research and analysis using primary and secondary data to examine the demographic and psychographic profiles of businesses and their owners in Wales, their succession aspirations and levels of knowledge of the options available.

Alongside this, the brief included a requirement to map out the range of existing support packages that are available to support business owners in their succession planning process, and to provide recommendations for the most appropriate support packages that can be promoted and delivered through the wider Business Wales service offer.

Methodology

The methodology adopted for this study combined primary and secondary research approaches as follows:

- A desk review considering the policy context and existing research for SME succession planning to inform the research framework for the subsequent SME survey and the stakeholder interviews;
- A survey of SMEs in Wales was undertaken to understand succession planning needs and their experiences with the existing succession planning support infrastructure;

- Stakeholder interviews with those providing succession planning support for SMEs in Wales to identify gaps in support provision;
- All research results were triangulated to identify where market failures in relation to succession planning in Wales existed. Recommendations for the most appropriate support packages that could be promoted and delivered through the wider Business Wales service offer were developed on that basis, including for the promotion of employee ownership models.

Business succession planning in Wales

Business succession planning needs to be framed in the wider context of economic policy objectives for Wales. In Wales, the Programme for Government commits the Welsh Government to the pursuit of ‘a stronger, fairer economy, improved and reformed public services, and a united, connected, and sustainable Wales’.

The SME sector is essential to the Welsh economy. An important focus rests on understanding how the longer-term development of SMEs in Wales can be encouraged and supported and what effects different succession approaches are likely to have on the nurturing of a Welsh ‘Mittelstand’. Understanding the prospects and choices for succession planning by Welsh SMEs and planning for the survival and growth of SMEs once the owner(s) withdraw(s) from the business is an important part of this.

The services delivered via Business Wales play a crucial role in ensuring that the Welsh Government contributes to the success of SMEs in Wales, and the Regional Entrepreneurship Acceleration Programme (REAP) can be expected to further strengthen the alignment of the support with economic policy objectives.

Three quarters of SMEs who responded to the survey, which formed part of this study and focused on businesses of between five and 50 employees, had not planned for the full transfer of ownership/closure of the business at all. Family ownership is a prevalent ownership structure in this cohort of SMEs.

Current succession planning support environment in Wales

The stakeholder interviews clearly highlighted the way in which succession planning needs to combine and weave together a plethora of different perspectives, dimensions and requirements in order to satisfy the needs of the different stakeholders involved while finding a viable solution for the business and the outgoing owner(s) going forward.

Interviewees overwhelmingly agreed that very little provision was in place in the current succession planning support landscape to invite and encourage business owners to engage with the subject in a timely way. Succession planning needs to have more prominence in public debate and owner-managers’ mindsets as an essential stage in any business’ life cycle.

SME owners tend to have very limited awareness of different succession options and their implications. Without the benefit of a strong Board, they often do not have the knowledge and skills of identifying and assessing the quality of more specific detailed advice.

Support is often targeted at businesses with at least £1 million or, depending on the source, £2 million or even £5 million in turnover. Limited understanding combined with affordability therefore means that SMEs often find it difficult to engage with the support that is available to consider options and prepare the business for a transfer of ownership.

Finance Wales and the Wales Co-operative Centre are able to cater to businesses that do not fit into these categories to some extent, but their reach into the SME community remains limited by the resources available and the limited attention SMEs pay to the issue. Business Wales is able to make business owners aware of the issue to some extent and a general consideration of owners wishing to exit the business at some point is likely to be part of broader business planning in one-to-one advice.

A gap analysis in terms of the skills and attitudes needed to drive the business forward, followed by mentoring, is an essential ingredient in business succession support. Both are available to a limited extent only.

Business succession crucially depends on being able to access and secure appropriate finance, including retirement planning. Access to capital was seen as not being an issue, including for Management Buy-Outs, but a finance gap exists where an SME's value is not easily visible to buyers or investors.

Many SME owners have unrealistic expectations regarding the price of their business and have a limited understanding of the detailed tax, legal and due diligence implications of selling their business. Support is available, but may not be appropriate or affordable for smaller SMEs. Professional advisors' knowledge of the specific opportunities related to an Employee Buy-Out is limited.

Access to support for different cohorts of SMEs

A key task in addressing the issue of succession planning for SMEs in Wales consists in identifying different SME cohorts' specific needs and opportunities in relation to succession planning.

A focus on 'deals' in the professional community directs attention towards SMEs with a strong existing strategic proposition. This cohort was estimated to be somewhere in the region of 5% of SMEs in Wales. Access to support is further likely to be affected for a large majority of SMEs in Wales by the business models adopted by professional advisors. As a result, the majority of SMEs do not prioritise succession planning themselves and are not on the radar of professional services' marketing efforts either.

There is a risk that SMEs that may offer particular opportunities to anchor business ownership and the associated economic activity and employment in Wales may not be reached by this support and not catered to adequately. Business growth as the key criterion for both the allocation of public sector-sponsored enterprise and business support and

interest from financial institutions and investors may not be sufficient in identifying SMEs that are important within their local economic structure.

A backlog from the 2008 financial crisis and the age structure of SME owners in Wales can be expected to create additional pressures to make succession planning support more widely available to those SMEs that do not, as a matter of course, seek out such support.

Overall, even recognising that some SMEs are genuinely too small or too niche to warrant any succession support, a considerable number of SMEs in Wales are therefore not being alerted to the need to plan for succession and/or potentially find it difficult to access or afford appropriate support. And yet, from a public policy perspective, these SMEs have a considerable contribution to make to sustaining the overall vibrancy of the Welsh economy. The notion of 'building value' through a staged process of planning for and implementing a transfer of ownership is likely to be highly relevant to many of these businesses.

Two main market failures can be identified that prevent SMEs in Wales from taking up optimum levels of succession planning support:

1. A structural market failure exists in the sense that the valuation of a business for a sale or investment proposition may not adequately reflect the value of that business to the local economy in terms of employment and the vibrancy of the local economy.
2. Information-related market failures exist in the sense that owners are not sufficiently aware of the different succession options and their implications and, therefore, do not embark on succession planning at an early enough point in time.

Targeting of different SME cohorts

Wider Welsh Government economic development policy objectives and links to the Wellbeing of Future Generations pledges should be kept in mind in deciding which cohorts of SMEs should be targeted with additional succession planning support.

A focus on nurturing the kind of entrepreneurial culture that uses strong management disciplines to underpin business growth and to promote the skills base to feed into the overall business stock in Wales can help to reconcile potentially conflicting economic policy objectives.

A useful segmentation of SMEs in relation to their specific succession planning needs must go beyond an analysis that is purely based on aspects such as the age of owner-managers or company size. While such markers will help to identify businesses that may face succession issues in the near future, limiting the analysis to this level would not be conducive to maximising the possible contribution of a focus on succession planning for the Welsh economy.

The Scottish model offers a template of how succession planning can be delivered in a way that takes an in-depth understanding of an individual SME's specific situation as its starting point and tailors a response to the particular requirements.

Conclusions and recommendations

Succession planning has an important role to play in delivering on economic policy objectives in Wales. Much of the specialised technical support for succession planning as called for by SMEs is available in principle.

Unrealistic SME expectations regarding the value of their business and the likelihood of finding a buyer who is willing to pay a 'strategic premium' for the business in a trade sale require a focus on awareness raising of other options such as an MBO or employee ownership as alternatives.

A gap in market-based provision for smaller SMEs and those requiring more intensive support in strengthening their strategic position by 'building value' needs to be addressed by strengthening narratives around strategic business development as an essential ingredient in SME growth and resilience throughout the business life cycle.

Identifying SMEs that would warrant public sector-sponsored succession planning support needs to go beyond simplistic markers such as turnover or the age of the owner(s) and to take into account the business' strategic outlook, its position in the market and its contribution to the local economic fabric.

Finance Wales and the Wales Co-operative Centre have strong visibility in the context of succession planning support for SMEs and were repeatedly identified as agencies that could potentially play a greater role in succession planning, while there is an opportunity for Business Wales to further strengthen the way in which one-to-one interactions with SMEs are levered to communicate such messages to the wider SME community.

Recommendation 1: Develop a clear policy statement regarding the importance of SME succession planning for the Welsh economy.

Recommendation 2: Confirm and enhance the Business Wales offer to support SME succession planning and ensure that all Business Wales advisors have the requisite skills to support general SME succession planning.

Recommendation 3: Work collaboratively amongst the Welsh Government, Finance Wales, the Wales Co-operative Centre and the professional advisor community to run a joint awareness-raising campaign, promoting the diversity of succession options and creating an integrated offer.

1 Introduction

Section Summary

- Mounting anecdotal evidence that Welsh SMEs facing succession planning issues could be detrimental to the Welsh economy as a whole motivated this research, which was commissioned jointly by the Wales Co-operative Centre and the Welsh Government.
- The Welsh economy was seen to be especially vulnerable to SME succession failure, because it is reliant on micro-businesses and rural areas depend heavily on key employers.
- The study undertook market research using primary and secondary data to examine SMEs' succession aspirations and knowledge, and mapped existing support packages.
- A particular focus in the research rested on considering the potential to promote employee ownership approaches to the betterment of the Welsh economy.

1.1 Background to this study

In March 2017, the Welsh Government and the Wales Co-operative Centre commissioned Wavehill to undertake research and analysis into the business succession issues facing businesses in Wales, focusing on two aspects:

- The support requirements of the Welsh SME sector with regard to generalist business support around succession planning and implementation, and
- The benefits and opportunities afforded by heightened awareness of, and support for, transforming businesses into employee ownership as part of a planned succession approach.

Commissioning the research was motivated by the realisation that there was mounting anecdotal evidence suggesting that Welsh SMEs are facing succession planning issues that could potentially be detrimental to the Welsh economy as a whole. This research will contribute to both the Welsh Government's and the Wales Co-operative Centre's understanding of the scale of the problem and designing relevant approaches to address it.

Business succession occurs in Small and Medium-Sized Enterprises (SMEs) when owner-managers decide to exit a company, often because they wish to retire after building up a business, sometimes over many decades. Many successful businesses fail every year because succession is handled badly. Some estimates suggest that a third of all business closures can be seen as succession failures.

The owner exiting the business is an essential part of the business life cycle: from the owner's perspective in that only with appropriate, timely attention will they have a realistic chance of realising their investment in the business; from employees' perspective in that timely attention can secure a business' strategic position in the market; and from the perspective of the Welsh economy as a whole in that the employment and wealth creation provided by SMEs can only be retained and higher rates of SME growth achieved if succession planning becomes part of a full understanding of the SME business life cycle.

The Wales Co-operative Centre and the Welsh Government have identified that there are serious economic and social costs associated with business succession failure which can be avoided by planning and implementing a considered succession strategy. Elements of the Welsh economy may be particularly affected by this, because:

- It relies, to some extent, on micro-businesses of fewer than 10 employees, which are often more dependent on the founder and, therefore, more difficult to sell.
- Rural areas depend more heavily on the sustainability of key employers, who might either close or leave the area as a result of succession.

1.2 Study aims

The requirement for the study was to undertake market research and analysis using primary and secondary data to examine the demographic and psychographic profiles of businesses and their owners in Wales, their succession aspirations and levels of knowledge of the options available.

Alongside this, the brief included a requirement to map out the range of existing support packages that are available to support business owners in their succession planning process, and to provide recommendations for the most appropriate support packages that can be promoted and delivered through the wider Business Wales service offer.

A particular focus in the research rested on considering the potential to promote employee ownership approaches to the betterment of the Welsh economy. Employee ownership offers a succession strategy that is suitable for many business owners; however, it is not widely promoted by professional business advisors, despite tax incentives and a growing body of evidence that demonstrates the success of the approach.

Building on the 'Defusing the Business Succession Time-bomb' publication released by the Wales Co-operative Centre in 2012, this part of the study required an update of the policy, taxation and legislative environment for employee ownership that would allow the interpretation and contextualisation of the evidence gathered within UK and Welsh devolved economic policy.

1.3 Methodology

The methodology adopted for this study combined primary and secondary research approaches as follows:

- A desk review was undertaken to consider the policy context for SME succession planning, identify existing research and develop a research framework for the subsequent SME survey and the stakeholder interviews.
- A survey of SMEs in Wales was undertaken to understand SMEs' succession planning needs and their experiences with the existing succession planning support infrastructure.
- Stakeholder interviews were undertaken with a cross-section of stakeholders providing succession planning support for SMEs in Wales to identify gaps in support provision.
- All research results were triangulated to identify where market failures in relation to succession planning in Wales existed. Recommendations for the most appropriate support packages that could be promoted and delivered through the wider Business Wales service offer were developed on that basis, including for the promotion of employee ownership models.

2 Business succession planning in Wales

Section Summary

- Business succession planning needs to be framed in the wider context of economic policy objectives for Wales. In Wales, the Programme for Government commits the Welsh Government to the pursuit of ‘a stronger, fairer economy, improved and reformed public services, and a united, connected, and sustainable Wales’.
- The SME sector is essential to the Welsh economy. An important focus rests on understanding how the longer-term development of SMEs in Wales can be encouraged and supported and what effects different succession approaches are likely to have on the nurturing of a Welsh ‘Mittelstand’. Understanding the prospects and choices for succession planning by Welsh SMEs and planning for the survival and growth of SMEs once the owner(s) withdraw(s) from the business is an important part of this.
- The services delivered via Business Wales play a crucial role in ensuring that the Welsh Government contributes to the success of SMEs in Wales, and the Regional Entrepreneurship Acceleration Programme (REAP) can be expected to further strengthen the alignment of the support with economic policy objectives.
- Three quarters of SMEs who responded to the survey, which formed part of this study and focused on businesses of between five and 50 employees, had not planned for the full transfer of ownership/closure of the business at all. Family ownership is a prevalent ownership structure in this cohort of SMEs.

2.1 Policy context

2.1.1 Economic policy objectives

Business succession planning needs to be framed in the wider context of economic policy objectives for Wales. Key amongst those objectives in Wales, the UK and the wider developed world are productivity and economic growth on the one hand and wider sustainability considerations (from social justice and equitable outcomes to environmental protection) on the other hand.

A 2017 House of Commons Briefing Paper¹ identifies plans for a new Industrial Strategy as being key amongst UK government policies to strengthening the UK economy. The introduction to the associated Green Paper suggests that the strategy is *‘about coordinating a wide range of economic policies to achieve particular objectives, which need not be purely economic. For example, an industrial strategy can have social and environmental aims.’*²

¹ House of Commons Library (2017), Productivity in the UK, Briefing Paper Number 06492

² House of Commons Library (2017), Industrial strategy, Briefing Paper Number 07682, 31 January 2017

The document makes a distinction between horizontal and sectoral policies and introduces the notion of mission-driven policies.

Business support, including a consideration of SME succession planning, clearly belongs in the category of horizontal policies, but is also inspired by the mission to stimulate economic growth in a way that benefits people in different parts of the country and in different industries while adding to the vibrancy of the economy overall.

In Wales, the Programme for Government commits the Welsh Government to the pursuit of *'a stronger, fairer economy, improved and reformed public services, and a united, connected, and sustainable Wales'*³. The focus of economic policy is neatly summed up in the Cabinet Secretary for the Economy and Infrastructure's 2016 invitation to stakeholders to contribute their observations and ideas for the priorities of the economy, answering the questions of how Wales' economy can be improved, to grow prosperity and deliver greater financial security to businesses and individuals, and how more home-grown, innovation-driven enterprise can be developed⁴.

Welsh Government is currently developing four cross-cutting and intertwined strategies under the four main headings of 'Prosperous and secure', 'Healthy and active', 'Ambitious and learning' and 'United and connected'. The aim is to work collaboratively with a wide range of interested partners and embed preventative thinking and long-term approaches in policymaking while considering how the Welsh Government can use the levers available to have the greatest impact⁵.

Alongside this, sustaining business confidence at a time of great uncertainty (following the Brexit referendum) is a key priority for the Welsh Government. This includes business engagement alongside more tangible interventions such as the launch of the Welsh Government Growth and Prosperity Fund⁶.

The services delivered via Business Wales play a crucial role against this backdrop in ensuring that the Welsh Government contributes to the success of start-ups and SMEs in Wales. With a focus on growth businesses, the service offers a broad range of scalable supports catering to start-ups and SMEs in different settings and environments.

Also under the Business Wales umbrella, the work that is currently undertaken under the banner of the Regional Entrepreneurship Acceleration Programme (REAP) can be expected to further strengthen the alignment of the support with economic policy objectives, as they relate to the Welsh business support network, underpinning entrepreneurship, innovation, and job creation.

³ Welsh Government (2016), Taking Wales Forward 2016-2021

⁴ See <http://gov.wales/topics/businessandconomy/welsh-economy/priorities-for-the-economy/?lang=en>

⁵ Council for Economic Renewal (2016), Discussion on Programme for Government, <http://gov.wales/docs/det/meetings/161020-cfer-item-5-en.pdf>

⁶ Council for Economic Renewal (2016), Discussion on Programme for Government, <http://gov.wales/docs/det/meetings/161020-cfer-item-5-en.pdf>

This sits alongside a renewed focus on the availability of finance for SMEs, as exemplified in the 2013 Access to Finance Review and the plans for Finance Wales to evolve into the Development Bank of Wales, which will be tasked with providing more than £1 billion of investment support to Welsh business over the next five years. Ensuring that micro- to medium businesses in Wales have greatly improved access to finance, support services and management advice is a key objective for the new Development Bank.

2.1.2 Focus on SMEs

The SME sector is essential to the Welsh economy. Making up 99% of the business count, SMEs account for 62% of private sector employment in Wales⁷. The vital importance of SMEs in Wales is reflected in the Welsh Government's ongoing commitment to providing support and finance to SMEs. Over £50 million to be distributed by the WG and Finance Wales to help SMEs to expand (including a fund to support management buy-outs of high-growth-potential SMEs) was announced over the course of 2016.

A recent report by the FSB identified priorities for enhanced provision for SMEs, including better access to finance, but also raised the need to support training and business skills. Importantly, the report also calls for measures to *'allow Welsh owned SMEs to grow into major employers without necessitating ownership (and therefore control) being lost to outside Wales'*⁸.

And yet, a subsequent FSB-sponsored report⁹ considering the lack of a 'Mittelstand' in Wales identified the early exit of owner-managers followed by *'churning of ownership'* as a key issue. The report recommends an overhaul of UK-wide policies supporting lending and equity investment in SMEs and tax incentives for investors and entrepreneurs.

Similar sentiments are voiced by contributors to a TUC publication debating Industrial Policy in Wales, which suggests that *'SMEs generate pass the parcel employment when the family sells out and the firm is passed between corporates like Rachel's Dairy which has successively had American and French owners'*¹⁰. Another contributor deplores *'a low level of policy commitment to supporting and developing the role of indigenous employers, particularly in manufacturing and in the broad-based SME sector. Local supply chain development and the fostering of SME growth, merger and consolidation can provide significant employment potential.'*

An important focus therefore rests on understanding how the longer-term development of SMEs in Wales can be encouraged and supported and what effects different succession approaches are likely to have on the nurturing of a Welsh 'Mittelstand'.

⁷ Welsh Government (2016), Size analysis of Welsh businesses statistical first release, November 2016

⁸ FSB (2015), Changing the Conversation: Opportunities and Practicalities involved in establishing a Wales Small Business Administration (WSBA), Centre for Enterprise. Cardiff School of Management

⁹ Brill L, Cowie L, Folkman P, Froud J, Johal S, Leaver A, Moran M & Williams K (2015), What Wales Could Be, CRESC Report for FSB Wales

¹⁰ Wales TUC (no date), Debating Industrial Policy in Wales

2.2 SME perspectives on succession planning

There clearly is a strong case to ensure that the right policy tools are available to secure the long-term sustainability of SMEs and safeguard the employment that they create. To achieve this, the determinants of the sustainability of SMEs need to be understood in order to ensure that the kinds of support that can help to maximise their potential to contribute to prosperity in Wales are in place. Planning for the survival and growth of SMEs once the owner(s) withdraw(s) from the business is an important part of this.

The Longitudinal Small Business Survey (LSBS) 2015¹¹ found that one in five (21%) SMEs in Wales was planning closure or succession in the next five years and a 2012 Wales Co-operative Centre report¹² found that small business owners in Wales tend to hold on to their firms for longer than the UK average. Clearly, understanding the prospects and choices for succession planning by Welsh SMEs is therefore important.

This picture is confirmed by the SME survey undertaken for this study. The survey focused on businesses of between five and 50 employees, because, based on findings from the LSBS, they account for an estimated 23% of all anticipated transfers (with the vast majority of the remainder having zero to four employees) and 12% of all anticipated closures whilst collectively representing over 50% of all employees likely to be affected by transfers or closures over the next three years. The survey undertaken for this study identified that 7% (20/307) of those surveyed had planned for transition of ownership or closure in the next three years, whilst a further 16% (50/307) have thought about succession planning in the longer term, leaving three quarters of respondent SMEs who had not planned for the full transfer of ownership/closure of the business at all.

Amongst those who had no succession plan in place, 29% (69/236) had thought about succession planning “often” or “sometimes”, whilst the remaining 71% (167/236) had thought about it “rarely” or “never”.

When asked why they did not have a succession plan, almost three quarters (73%; 138/189) said that it was not something that they had considered, a further 24% (45/189) described not having the time to think about it, whilst only 1% of respondents felt that they did not know how to approach succession planning.

2.2.1 Family ownership

The survey results also confirm that family ownership is a prevalent ownership structure in this cohort of SMEs (56%; 179/321), which is broadly similar to the proportion of family ownership across the UK (67%)¹³. However, the majority of survey respondents had been in family ownership for one generation only. Moreover, family ownership did not seem to have any significant effect on the likelihood of undertaking succession planning.

¹¹ BIS (2015) *The UK Longitudinal Small Business Survey*

¹² Wales Co-operative Centre (2012), *Employee ownership: Defusing the business succession time-bomb in Wales*

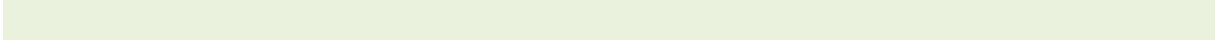
¹³ <http://www.ifb.org.uk/voice/uk-family-business/>

Family-owned businesses were also asked whether there has been any agreement to date to pass on the business within the family, or if there is a possibility of doing so in the future. The sample was split fairly evenly: 45% (81/179) said that there either was an agreement (40%) or might be one in the future (5%) to pass on the business in the family, whereas 47% (85/179) said that there has been no agreement to date. Interestingly, 27% of family-owned businesses surveyed described not having any form of succession planning, yet subsequently stated that they planned to pass the business on within the family. This illustrates the prevalence of informal succession activities amongst family-owned businesses.

2.3 Current succession planning support environment in Wales

Sub-section Summary

- The stakeholder interviews clearly highlighted the way in which succession planning needs to combine and weave together a plethora of different perspectives, dimensions and requirements in order to satisfy the needs of the different stakeholders involved while finding a viable solution for the business and the outgoing owner(s) going forward.
- Interviewees overwhelmingly agreed that very little provision was in place in the current succession planning support landscape to invite and encourage business owners to engage with the subject in a timely way. Succession planning needs to have more prominence in public debate and owner-managers' mindsets as an essential stage in any business' life cycle.
- SME owners tend to have very limited awareness of different succession options and their implications. Without the benefit of a strong Board, they often do not have the knowledge and skills of identifying and assessing the quality of more specific detailed advice.
- Support is often targeted at businesses with at least £1 million or, depending on the source, £2 million or even £5 million in turnover. Limited understanding combined with affordability therefore means that SMEs often find it difficult to engage with the support that is available to consider options and prepare the business for a transfer of ownership.
- Finance Wales and the Wales Co-operative Centre are able to cater to businesses that do not fit into these categories to some extent, but their reach into the SME community remains limited by the resources available and the limited attention SMEs pay to the issue. Business Wales is able to make business owners aware of the issue to some extent and a general consideration of owners wishing to exit the business at some point is likely to be part of broader business planning in one-to-one advice.
- A gap analysis in terms of the skills and attitudes needed to drive the business forward, followed by mentoring, is an essential ingredient in business succession support. Both are available to a limited extent only.



- Business succession crucially depends on being able to access and secure appropriate finance, including retirement planning. Access to capital was seen as not being an issue, including for Management Buy-Outs, but a finance gap exists where an SME's value is not easily visible to buyers or investors.
- Many SME owners have unrealistic expectations regarding the price of their business and have a limited understanding of the detailed tax, legal and due diligence implications of selling their business. Support is available, but may not be appropriate or affordable for smaller SMEs. Professional advisors' knowledge of the specific opportunities related to an Employee Buy-Out is limited.

The stakeholder interviews provided a further perspective on the issues that SMEs in Wales face with regard to succession planning and the extent to which these are currently being addressed by the support environment. The interviews clearly highlighted the way in which succession planning needs to combine and weave together a plethora of different perspectives, dimensions and requirements in order to satisfy the needs of the different stakeholders involved while finding a viable solution for the business and the outgoing owner(s) going forward. This context is suitably captured in a quote from research undertaken by one of the corporate financial advisory firms:

*'Unless you are a serial entrepreneur who has been down this road before, the decision to sell your business is a step into new territory. Even if you have experience in selling a business, each new sale represents a different set of circumstances, a different cast of characters, and a unique set of unforeseen challenges.'*¹⁴

The initially envisaged approach to mapping the support infrastructure on the basis of a matrix identifying different components of support proved not to be a useful tool with which to capture and analyse the support currently available for succession planning in Wales. The nature of the considerations and inputs that need to be sourced in the course of successfully transferring ownership of a small or medium-sized business in Wales is reflected in the contextual nature of the discussion of the Welsh succession planning support landscape in the following sections.

2.3.1 Putting succession planning on SME business owners' agenda

What support do SMEs in Wales need?

SME business owners taking the initiative to consider different options regarding their exit from the company early enough — with a time horizon of at least two or three years, ideally up to five years — was highlighted as a key first step by virtually all stakeholders interviewed for this study. And yet, interviewees overwhelmingly agreed that very few owners approach this question with the same vigour and commitment that they apply to running their company.

¹⁴ Gambit Corporate Finance, What You Should Know Before Selling Your Business

Referring to existing evidence and their own experience, interviewees agreed that most SMEs did not do anything, did it too late or did it only superficially, effectively ignoring or merely reacting to events during this important part of the SME life cycle. SME owners often see it as their life and career to build the business; stopping is anathema and, therefore, is not on their radar. Many SME owners are also reluctant to discuss the matter openly, because they fear that this will create uncertainty for their business, internally with employees and externally with customers and suppliers. That said, only 3% (5/190) of business survey respondents in our study cited succession planning as '*a sensitive issue that might create uncertainty for the company*' as a reason for not doing it.

Too often succession planning is undertaken in a reactive fashion, stimulated by an event, rather than proactively with the scope for shareholders to extract the best value. Suggesting that '*people underestimate the time and resource required*', most stakeholders saw two years as the minimum requirement to carry out appropriate forward planning for a transfer of ownership.

Succession planning needs to have more prominence in public debate and owner-managers' mindsets as an essential stage in any business' life cycle. Changing the narrative around entrepreneurship and the SME business life cycle was seen as a vital step in changing SME succession planning practices in Wales. It needs to cover an understanding of a business' growth trajectory beyond start-up and early years and stretching beyond the owner-manager's own involvement in running the company.

What support is available to SMEs in Wales?

Stakeholders agreed that in the current succession planning support landscape, very little provision was in place to invite and encourage business owners to engage with the subject in a timely way. Very few public agencies or professional advisors proactively identify and target SMEs that require succession planning support and much is left to '*conversations in the pub*' and networking amongst the professional advisor community.

Finance Wales' awareness-raising activities — delivering seminars, succession planning clinics, and proactively engaging intermediaries (e.g. FSB, IoD, ACCA, ICAW) and professional advisors — were highlighted repeatedly as the exception and a highly appropriate and valuable approach. FW has more recently also started to undertake direct marketing for the overall portfolio of its finance solutions with succession planning as a key element of the pitch. Thus far, however, doubts have been expressed about the current reach of these activities.

Those SME owners who retain an accountancy firm — typically larger SMEs with more complex tax arrangements — are likely to touch on the issue in their regular discussions of business planning and accounting matters. However, the primary focus of interactions and the one-off transaction setting of the typical contractual relationship do not lend themselves to generating sufficient prominence for succession planning. Many SME owners, however, are unlikely to go out of their way to obtain sufficient information beyond this first port of call.

Accountants, corporate finance advisors and other professional advisors are beginning to pay more explicit attention to the issue and are developing business models for the provision of more targeted support. One accountancy stakeholder interviewed for this study also suggested that enquiries were increasingly received outside of the company's regular client base with around 70% of one-off transactions through referrals or direct contact from SME owners, with many deals being of relatively low value compared to the industry average. Nevertheless, the reach of such services in terms of sheer volume has, thus far, been limited.

Business Wales as the main gateway and portal for publicly sponsored enterprise and business support for a wider population of SMEs in Wales is able to make business owners aware of the issue to some extent. No data were available from BW on the prominence of this as an issue in SME enquiries, but interviewees suggested that a general consideration of owners wishing to exit the business at some point is likely to be part of broader business planning in one-to-one advice. The stakeholders interviewed for this study perceived Business Wales to be mostly catering to micro-businesses, and feedback from the professional advisor community indicated that referrals from Business Wales advisors into dedicated succession planning support are not a frequent occurrence.

The Wales Co-operative Centre through the Social Business Wales service has a more explicit focus on succession planning. With work having been done to strengthen its visibility as the 'go-to' organisation for succession situations in which an owner wishes to consider employee ownership to be an option, referrals were beginning to be made by Business Wales advisors. Similarly, professional advisors identified the Wales Co-operative Centre as the agency that they would call on for any client requests for support related to employee ownership.

2.3.2 Succession planning and building value in the business

What support do SMEs in Wales need?

Identifying and appraising options

As a result of this gap in awareness raising, *'the mystery of exit is vast'*, as one stakeholder put it. Where SME business owners are alert to the need to plan, without the benefit of a strong Board, they often do not have the knowledge and skills of identifying and assessing the quality of more specific detailed advice. For those that have given succession planning some thought, the survey provides evidence that many of them would find succession planning support valuable. Tax planning, financial and investment planning and support for transitional processes are top of the list in that respect.

SME owners tend to have very limited awareness of different succession options. Many assume that selling the business to an external buyer is the only option. And yet, the experts interviewed for this study widely agreed that *'for anything below a £5mio turnover, it's hard to find interested buyers, even for successful profitable businesses'*. To put this into the context of business size in terms of employment, the average turnover (revenue) per employee in the Welsh economy is £104,000¹⁵, so a turnover of this scale typically equates to medium-sized enterprises and above (>50 employees).

SME owners may be so determined to pursue a trade sale for their exit from the business that accountants will *'often go through the process of a trade sale, merely to convince businesses of an MBO'*, as one accountancy interviewee described it. Research into attitudes of high-net-worth clients of a private banking and wealth management firm referenced by one interviewee¹⁶ suggests that a vast majority were not considering an MBO and were only interested in a trade sale, while of those that had gone through an MBO, 85% were happy with the buy-out process.

SMEs are also often not aware of the implications of different options for their exit. Engaging in a trade sale, for instance, may require them to open their books to a competitor (who may be *'on a fishing expedition'* rather than being genuinely interested in buying the business) and to sign up to warranties, etc. that create a legacy of personal risk.

A detailed financial and operational assessment of the business and the implications of different exit routes two to five years before an expected sale is therefore a key requirement in gaining a clear picture of the full range of options.

The buyer may be a former senior manager who wants to be his/her own boss, in which case the transaction of buying into an existing SME will be a journey for them, too. The purchase may be part of another SME's well-executed strategy of looking for a business with a strategic fit, but a buyer's interest may also be *'part of a finance driven feeding frenzy'*.

¹⁵ Analysis of Size Analysis of Welsh Businesses, 2016, Statistics for Wales

¹⁶ Coutts (2011), A special kind of exit: What really happens in a management buyout and why every entrepreneur should consider one

Choices are, to a large extent, bound up in *'people issues'*, from owners' aspirations and ambitions for their retirement to personal relationships with managers and employees. SME owners will, for instance, often not see an MBO as a viable option, assuming that the management team would not have access to the necessary finance or expecting to secure a greater financial return from selling the business to an external buyer, even where a management team, which could potentially take over the business, is in place.

Similarly, management teams are often purely seen as employees and both sides may be nervous about addressing the issue for fear that it might introduce uncertainty and undermine working relationships. External advisors can play a crucial role in having early conversations separately with the seller or an interested management team so that they can embark on more detailed conversations with an awareness of where the other party is at.

Generally speaking, understanding the motivations and aspirations of all stakeholders involved and their potential implications for different succession options was highlighted by interviewees as a prerequisite for supporting SME owners in making appropriate choices. The balance between owners' concern about their future personal wealth on the one hand and a commitment to the future prospects of employees on the other hand, for instance, is an important consideration in identifying an appropriate exit route.

Preparing the business for a transfer of ownership

Stakeholders consistently suggested that preparing the business for a transfer of ownership is a key feature of any succession planning process — regardless of the nature of the ultimate transfer. Since the aim is to develop an attractive funding proposition, this kind of value maximisation review was described by several interviewees as *'building value into the business'*.

At its most basic level, this notion relates to making existing value visible to potential buyers and/or funders, for instance, through strong management information and transparent contractual relationships with customers. One interviewee described the lack of quality management information, sometimes down to the most basic financial information (from P&L and balance sheets to cash flow and monthly accounts), even in some relatively large and profitable businesses, as a recurring theme in working with SMEs on succession planning.

Beyond this focus on evidencing existing strengths, building value in a business also extends to a business being well invested and not carrying too much debt. Having good visibility of forward revenue is another important feature. At one end of the scale, a business model allowing an SME to predict revenue for the next two to three years, for instance, predisposes a business to a strong succession plan. At the other end of the scale, where a business does not have an order book beyond the next three months, there will be little value for any buyer.

A value maximisation review will typically also include a gap analysis to identify strategic initiatives to strengthen the proposition made.

What support is available to SMEs in Wales?

Private sector succession planning support

Accountants play an important role in supporting SME succession planning. Medium-sized accountancy firms are able to support an SME succession journey. One interviewee compared the support available to that *'offered to larger clients by the Big Four firms'*. The business model underpinning this kind of support typically initially involves a period of three to six months on a retainer (e.g. at between £750 and £1500 a month). During this period, the team will either market the business from the start or, where there is already a buyer or an MBO is being considered, engage in the early arrangements. During this process, the team will act as a sounding board to support the owner through to a contract at the Heads of Terms stage. This involves hand-holding the owners in getting the business ready, getting the accounts in order, supporting their negotiations, etc.

Following this period, any subsequent work will be delivered on a fixed contingent fee basis of £20–30k, but this is only payable if the transaction completes. During this stage, the team will help the client through the due diligence process, liaise with lawyers, provide tax advice and put together completion accounts. This fee structure is mirrored throughout the industry, albeit at different fee levels.

This kind of support, however, is currently not universally available, because smaller independent accountants are unlikely to have the necessary skillset. Moreover, the established accountancy business model is not suited to delivering the kind of detailed options appraisal and ongoing support over a period of time that would allow SME business owners to take an objective look at what is and is not likely to deliver a good result.

However, the accountancy profession does have an important role to play in making the value in a business visible. The interviews undertaken for this study suggest that some accountancy firms are developing their services to accommodate the more strategic engagement with a business that is required to support a process of building value.

The interviews also revealed concerns on the part of some stakeholders that, more generally speaking, accountants may not, as a rule, have the ability to think in a dynamic fashion and offer the intellectual rigour required to engage with a business' strategic needs. This was associated with *'the rather static training of accountants, which is heavily compliance driven'*.

Corporate (finance) advisors are the second group of professionals who offer services in undertaking longer-term succession planning. Their main target group, however, comprises those SMEs that have a clear proposition to make to the marketplace and typically boast a turnover of £5 million or more.

There is some movement in this segment of the professional services market, with some firms developing an offer for businesses in a slightly lower turnover bracket of £2 million or above and work being undertaken to develop a clear process for succession planning that takes into account the diversity of issues, concerns and stakeholders that should ideally be involved¹⁷. The business model adopted by some corporate advisors is explicitly based on the assumption that *'succession advice must go beyond financial advice and transaction'*. Under this model, a longer-term engagement will typically involve a succession review in the context of a wider strategic review and can support the ongoing transformation of the respective business.

Nevertheless, the interviews undertaken for this study suggest that conventional succession planning is still typically characterised by a focus on financial aspects and structuring a deal – the aim is not business development per se. One interviewee commented that *'securing a deal is flattering for everyone, the buyer, the seller, the banks, the lawyers and accountants'*, but called for a longer-term development perspective for the respective business to be embedded in the approach. This was seen to create a risk of not paying sufficient attention to less market-based options such as an MBO or an Employee Buy-Out as an exit route for SME owners.

Public sector succession planning support

In contrast, stakeholders were highly complimentary about the role and quality of support of both Finance Wales and the Wales Co-operative Centre. Both organisations were also seen as having strong visibility in the succession planning space.

With its particular focus on employee ownership, the Wales Co-operative Centre's approach focuses on supporting owners in exploring this as an option, and securing engagement from the wider staff base is a core part of the Social Business Wales offer in that area.

Finance Wales' role in supporting succession planning is closely linked to its role as a finance provider through the Business Succession Fund. Consequently, FW cannot give formal financial advice. However, FW investment executives are able to *'take businesses on a journey'* and consider their position at a high level over the course of managing the specific FW transaction, which will typically take between 18 months and two years. During this process, FW will touch base with businesses on a quarterly basis.

Beyond the, by now, well-established way of delivering the Business Succession Fund, FW is currently also piloting an approach of directly targeting the management teams of companies that are likely to face succession in the near future so as to consider the implications if they were to make a pitch for ownership of the business.

¹⁷ For example, the [STEP succession planning product](#) developed by Gambit Corporate Finance through a KTP with Cardiff University

The Wales Co-operative Centre currently has no dedicated business succession support but, as part of its delivery of the Social Business Wales service, is able to extend support to SMEs with growth potential that are considering employee ownership or other co-operative or mutual business models as part of the owner's exit from the business.

Some stakeholders expressed caution regarding the risk of an overreliance on these two organisations' existing services, as they are both based on a particular focus and approach. Finance Wales is essentially a finance provider, while the Wales Co-operative Centre is committed to promoting employee ownership as a particular model of business succession. This was seen to potentially '*close the door to a broader conversation*'.

Initiatives focusing on making businesses 'investment-ready' were referenced by one stakeholder as addressing the notion of building value in the business. However, these initiatives tend to focus on young technological businesses or social businesses.

2.3.3 Mentoring and filling skills gaps

What support do SMEs in Wales need?

A key aspect of building value relates to ensuring that the necessary skills and expertise are available to lead the business once ownership has been transferred. The classic wisdom is that in order for a business to have value, the owner must begin to make him/herself less essential while nurturing the management talent that will allow the company to trade successfully post exit.

Replacing the outgoing CEO is important, but enabling the business to adapt to new circumstances following the transfer of ownership is equally important. '*The business will be very different following succession, because it will have a level of financial debt that hasn't been there before,*' as one interviewee put it. Servicing debt finance requires a refreshed emphasis on growth and the ability in the management team to deliver such growth.

Stakeholders commented that even in many successful, profitable SMEs, it is financial skills in particular that are often missing. Finding a capable Finance Director is therefore often a priority.

The question of skills and expertise and of ensuring that the team taking over the business has what it takes to generate new energy and make the most of new opportunities for the business is all the more relevant to scenarios in which ownership is transferred to existing members of the team, be it through an MBO or through an Employee Buy-Out. In these settings, the issue is not limited to the availability of skills and expertise, but also relates to adapting company culture and developing suitable governance arrangements. It is important that everyone understands the different hats that they need to wear, from an employee/worker role to a shareholder/ownership role and a Director/fiduciary role. '*People will often wear the wrong hat*' and avoiding this requires coaching and mentoring.

With this in mind, stakeholders agreed that a gap analysis in terms of the skills and attitudes needed to drive the business forward was required. Mentoring to more generally support the people side of the transition into new ownership was an essential building block of successful business succession.

What support is available to SMEs in Wales?

A mentoring role is often delivered by introducing a non-executive director to the business. Finding the right ones, however, was described by one stakeholder as being *'like a marriage bureau'*. With the ranks of corporate (finance) advisors in Wales growing, this service is increasingly available to SME owners wishing to undertake succession planning.

Where SME owners seek out dedicated succession planning support from corporate (finance) advisors, putting in place a capable management team and ensuring a strong challenge and support function of the Board will be a focus of attention. This is because it is a crucial aspect for which investors will look when making investment decisions. However, its success crucially depends on sufficient time being allocated to the process, with stakeholders concurring that a time horizon of at least two or three years is necessary to do this successfully.

In supporting SME business succession, Finance Wales has a particular emphasis on undertaking a gap analysis and supporting businesses in getting ready to present a coherent investment case to potential buyers or investors. Under the SME Succession Fund, this includes the right to appoint a non-executive director to the Board or to require the addition of key skills to the management team, more often than not an FD, but also operations, geographical expansion, etc.

There is also evidence that some professional advisors are able to support the people side of things in terms of creating a workable structure for participation and control in the business, e.g. in relation to a Management Buy-Out.

More often than not, the emphasis on people, however, does not translate into a dedicated role for HR professionals or a more in-depth consideration of people development in the business. One corporate advisor suggested that *'while the issues covered by the term are crucial, there is no space in this kind of deal to bring in specialist HR advisors'*.

2.3.4 Accessing finance

What support do SMEs in Wales need?

Regardless of the form that it takes, business succession depends on being able to access and secure appropriate finance. This may relate to raising finance so as to enable a Management Buy-Out or Buy-In, to financing an Employee Ownership Trust, to finding equity investors or to structuring financial relationships between the exiting owner and the business under new ownership.

Finance is so important for succession planning that several stakeholders pointed out that any succession process ultimately hinges on the financial deal at the centre of the transaction. This is because securing the right finance depends on fully understanding, managing and communicating the balance between risks and rewards. This is particularly important for the future sustainability and growth potential of the business.

Retirement planning is also an essential part of succession planning. Considering what the vendor might get out on day one and what annuity of income they can expect is closely tied up with the structure of any external finance that might be required. Options such as continuing rental income from a building, etc. and the question of how long the exiting owner(s) may want to be tied into the business (e.g. for an 'earn-out') will need to be considered.

What support is available to SMEs in Wales?

Many interviewees highlighted the important role of Finance Wales in acting as the leading lender for smaller businesses in a succession situation. Most stakeholders who commented on their role suggested that FW takes a carefully assessed and balanced view of risk and prices its finance accordingly. FW is able to support a wide range of business succession deals, ranging from Management Buy-Outs and Buy-Ins and combinations thereof to mergers and acquisitions¹⁸.

In comparison to other financiers — banks were highlighted as a particular example — most stakeholders also thought that FW got the balance right in terms of the guarantees, warranties, etc. that SMEs were required to provide in order to secure finance through their funds.

Finance Wales, primarily through the Wales Succession Fund, but also using debt finance through the Micro Business Loan Fund and the Wales Business Fund where necessary, is able to make debt and equity investments of between £50k and £3 million. Over 100 transactions have been completed to a value of £40m+ and a leverage of private investments of £100 million has been completed in recent years, with 15–20 transactions being completed per year.

Research by a leading legal firm in South Wales which considers the number of private equity-backed businesses in Wales compared to the rest of the UK suggests that *'Wales presents an under-utilised opportunity for private equity with many quality businesses ripe for investment'*¹⁹. Finance Wales does therefore provide the equity investment in Wales that — as confirmed by several stakeholders — is not forthcoming from investors elsewhere²⁰. Comparing the situation to other UK regions outside of South East England, one stakeholder commented that *'we are fortunate in Wales to have Finance Wales'*.

¹⁸ [Finance Wales Succession table](#)

¹⁹ Management Buy-Out – The way forward for your business? (2014), Hugh James
[\[https://www.hughjames.com/wp-content/uploads/2015/07/HJSpotlight_MBO_V2.pdf\]](https://www.hughjames.com/wp-content/uploads/2015/07/HJSpotlight_MBO_V2.pdf)

²⁰ Research does indeed suggest that only 2 per cent of all UK venture capital funding over the last decade was invested in Wales (see <http://dylanje.blogspot.co.uk/2017/02/venture-capital-in-wales.html>).

Banks, on the other hand, were seen as not very prominent players in the provision of finance for SME business succession in Wales. This was seen to be the result of bank managers having very limited discretion, with decisions being made by credit teams on the basis of credit scores.

In spite of these limitations, interviewees expressed the view that *'access to capital is not an issue'*, including for Management Buy-Outs. Linking back to comments about the need to build value in the business as part of succession planning, a finance gap was seen as the result of value not being visible. Several interviewees suggested that in those circumstances, leveraging the business, e.g. through deferred consideration or through asset-based finance, would be a way in which to bridge that gap. However, this was seen as not being sufficiently recognised and an aspect that could usefully be promoted.

One interviewee also highlighted that less conventional forms of finance, such as institutional money from funds, trusts, etc., were available now, albeit without the management support required for many small businesses.

However, cautionary comments from some interviewees suggest that much of this discussion is framed primarily in the context of an investment rationale. The optimism about the availability of finance may therefore be less justified when it comes to smaller businesses with an intrinsic value but without the ability to easily make this visible in order to secure finance. It creates a need to strengthen *'links between SMEs and professional advisers in securing the right type of funding for the business, especially as accountants and lawyers can play an important role in supporting SMEs' business decisions going forward'*²¹. Similarly, re-establishing SME links to their banks may be necessary to ensure that they can explore the full range of potentially available finance, including debt-based instruments.

Specific reference was also made to a scenario in which finance needs to be raised for mutual ownership models. Raising money, particularly risk money, may be more difficult under these circumstances, because funders are likely to view it as being difficult to secure the financial return. One interviewee also commented that under those circumstances, obtaining the kind of personal guarantee that funders are likely to require has the potential to create additional risk for the individuals involved in the case of a default.

2.3.5 Deal architecture

What support do SMEs in Wales need?

Valuing the business and identifying potential buyers

One interviewee summed up the answer to the question of how difficult it was to find external buyers by stating that *'there's always a market for a sale, it entirely depends on price'*. However, sales are often more of a strategic purchase and in view of the fact that stakeholders concurred that Welsh SMEs were not necessarily on the radar of equity or venture capital funders, finding a buyer willing to offer the right price is the key challenge for SME owners wishing to pursue an external sale for their business.

²¹ <http://dylanje.blogspot.co.uk/2016/11/the-cma-recommendations-on-funding-for.html>

The search for an external buyer may also be complicated by concerns about having to reveal commercially confident strategic information to potential competitors. The main need in terms of finding a buyer therefore relates to having a detailed understanding of the specific proposition that an SME can make to different buyers and how the future prospects of the business might be impacted by different types of sales.

The question of finding buyers is closely linked to the issue of business valuation. Interviewees highlighted that many SME owners have unrealistic expectations regarding the price of their business, particularly in terms of a potential strategic premium through a trade sale. As one interviewee commented, *'vendors believe that purchasers will pay a premium for the strategic advantage, but these expectations often get stripped away in the due diligence process'*.

In an MBO, valuation will often be a very personal thing that requires compromise, with the management team potentially paying slightly more and the owner getting slightly less.

Generally speaking, stakeholders pointed out that where debt is part of the finance package, the finance provider determines the price, because risks and returns have to be matched.

Making a transaction happen (due diligence, legal, tax, etc.)

In structuring a deal, the detailed tax and legal implications need to be considered and due diligence is required to release investment in any deal.

Tax implications are key, particularly when it comes to the structure of any deal; for instance, the rates of Capital Gains Tax that an exiting owner will incur depend on the nature and timing of any payments for his/her shares under Entrepreneurs' Relief. For example, while both the day one payout and Deferred Consideration for an owner incur 10% Capital Gains Tax under Entrepreneurs' Relief (as long as the owner is selling shares, not assets), what is described as an Earn-Out is taxed at 20%.

Any new owner will also want to conduct due diligence on the financial and commercial activities of the business to understand the potential risk involved. Where a structured process of succession planning with a focus on 'building value' has been adopted by an SME in good time, much of the due diligence information is likely to be at hand. Nevertheless, depending on the requirements of investors, additional work may be required. This needs to be factored into succession planning, both in terms of supporting SME owners in preempting and addressing any issues that might be identified in a due diligence process — or at least understanding the impact that they may have on the valuation of the business — and in terms of understanding the financial implications and potential negotiation delays that can be introduced through having to conduct due diligence on the business.

Finally, advice is required with regard to the legal transactions involved in the transfer of ownership, e.g. the level of detail required in the Sale and Purchase Agreement (SPA) and associated warranties or indemnities and the disclosure letter in order to limit any personal risk from a potential breach of warranty.

What support is available to SMEs in Wales?

The financial transactions associated with business succession are underpinned by a range of professional services, from accountancy and legal advice to due diligence on a number of different aspects of the business.

Accountants and corporate finance advisors can help to find an interested party for a (trade) sale through:

- On-market services such as circulating an information memorandum to interested parties or through subscription databases, or
- Confidential off-market services where business owners do not want their intentions to be widely known.

Accountants, corporate finance advisors, Finance Wales and the Wales Co-operative Centre all currently play a role in supporting the valuation process as part of SME succession planning. Existing tools and techniques can be used to provide '*a ballpark figure*' (e.g. using sector-specific multiples, price-earnings multiples or a business' asset base), but business valuation '*is not an exact science and ultimately the value is what somebody is willing to pay*'.

However, more awareness of such services and how they work might be needed. Smaller SMEs without strong tangible assets but with an intrinsic value to their local economy will, however, find it more difficult to find appropriate support in marketing their business and finding potential buyers.

The range of professional advisors referred to above — larger accountants, corporate finance advisors and Finance Wales — also provide advice and/or support for SME owners, and in the case of Management Buy-Outs the management team, in understanding the implications of different sources of finance and structuring the right deal, including retirement planning for the exiting owner. Accountants were singled out as '*the most important crutch*', because financial expertise is vital in understanding the future prospects of the business and finding tax-efficient ways of extracting value. Interviewees suggested that a focus on getting the '*deal architecture*' right was the key success factor. This includes legal advice²², in spite of the fact that one stakeholder suggested that '*many solicitors don't understand corporate transactions well enough*'.

With regard to the professional services required to complete the financial transaction behind business succession, affordability, however, was raised as an issue by one stakeholder, who suggested that while a risk-based fee structure is appropriate, this should be balanced by an understanding of what businesses can afford. Focusing on business succession as a transaction can lead to a situation in which extensive due diligence work is

²² It has not been possible to speak to representatives from the legal profession. References to their role in succession planning therefore stem from feedback from other stakeholders and publicly available research.

demanded, which may be disproportionate to the scale of the transaction and has the potential to derail the whole process.

Supporting an analysis of the detailed tax implications of an Employee Buy-Out is one area in which professional advisors appeared to have rather limited specific technical knowledge. Recent changes to the tax treatment of Employee Benefit Trusts following the Nuttall Review in 2012/13, for instance, did not seem to be fully on the radar of interviewees. Instead, the Wales Co-operative Centre was clearly seen as the go-to organisation for specific advice and support, with SME owners expressing an interest in exploring this as a succession option.

Representatives of the Wales Co-operative Centre itself confirmed that as a legacy of the Business Succession and Co-operative Consortia Project, the in-house team had been able to build up considerable expertise and an ability to advise on a wide range of aspects that are relevant to the transfer of ownership of an SME to employees. While not qualified to provide actual financial or legal advice, they are able to support a consideration of the corporate finance, tax and governance implications of such a process. The existing Social Business Wales framework is being used to source more detailed technical advice regarding the transfer of ownership itself, while any aspects relating to unwinding owners' personal tax affairs will be sourced by the owners themselves in the market.

In addition, the Wales Co-operative Centre has worked towards nurturing opportunities for peer support regarding employee ownership of which SME owners with an interest in this avenue can take advantage.

2.4 Access to support for different cohorts of SMEs

Sub-section Summary

- A key task in addressing the issue of succession planning for SMEs in Wales consists in identifying different SME cohorts' specific needs and opportunities in relation to succession planning.
- A focus on 'deals' in the professional community directs attention towards SMEs with a strong existing strategic proposition. This cohort was estimated to be somewhere in the region of 5% of SMEs in Wales. Access to support is further likely to be affected for a large majority of SMEs in Wales by the business models adopted by professional advisors. As a result, the majority of SMEs do not prioritise succession planning themselves and are not on the radar of professional services' marketing efforts either.
- There is a risk that SMEs that may offer particular opportunities to anchor business ownership and the associated economic activity and employment in Wales may not be reached by this support and not catered to adequately. Business growth as the key criterion for both the allocation of public sector-sponsored enterprise and business support and interest from financial institutions and investors may not be sufficient in identifying SMEs that are important within their local economic structure.

- A backlog from the 2008 financial crisis and the age structure of SME owners in Wales can be expected to create additional pressures to make succession planning support more widely available to those SMEs that do not, as a matter of course, seek out such support.
- Overall, even recognising that some SMEs are genuinely too small or too niche to warrant any succession support, a considerable number of SMEs in Wales are therefore not being alerted to the need to plan for succession and/or potentially find it difficult to access or afford appropriate support. And yet, from a public policy perspective, these SMEs have a considerable contribution to make to sustaining the overall vibrancy of the Welsh economy. The notion of ‘building value’ through a staged process of planning for and implementing a transfer of ownership is likely to be highly relevant to many of these businesses.
- Two main market failures can be identified that prevent SMEs in Wales from taking up optimum levels of succession planning support:
 1. A structural market failure exists in the sense that the valuation of a business for a sale or investment proposition may not adequately reflect the value of that business to the local economy in terms of employment and the vibrancy of the local economy.
 2. Information-related market failures exist in the sense that owners are not sufficiently aware of the different succession options and their implications and, therefore, do not embark on succession planning at an early enough point in time.

The above discussion of the support environment for SME succession planning paints a picture of the more specific advice and support required to enable SMEs to plan and implement the succession journey being readily available in Wales. And yet, the survey results suggest that many businesses on the ground simply do not seek it out.

A key task in addressing the issue of succession planning for SMEs in Wales therefore consists in identifying different SME cohorts’ specific needs and opportunities in relation to succession planning. Common factors that are often used to segment the SME market in relation to succession planning are the size of the business in terms of turnover, the age of owner-managers and the expected market value of the business. The technical report presenting the results from the business survey conducted for this study provides a perspective on Welsh SMEs’ outlook, understanding and experience of succession planning and how this is influenced by factors commonly associated with succession planning. The results are also briefly summarised in Section 2.2 above.

To some extent, the differing perspectives between the survey results and the stakeholder interviews will be down to the issue of awareness raising and SME owners spending limited time and energy on identifying and sourcing the support. In addition, however, the research undertaken for this study reveals that much of the professional advice primarily targets a particular cohort of SMEs. One interviewee referred to 12 deals with which the firm had been involved over the last year, suggesting that *‘the community is not vast’*.

Several interviewees referred to turnover brackets for those businesses that would typically use their support, usually identified as £2 million or above in turnover for medium-sized accountancy firms and starting from £5 million for corporate (finance) advisors. The latter, of course, coincides with the threshold identified by several stakeholders as being the minimum size for a company to be attractive for a trade sale and which broadly conforms to the transition from a small to a medium-sized firm in employment terms.

Joint research by Gambit, a corporate finance advisory firm headquartered in Cardiff, and Cardiff Metropolitan University profiled SMEs in Wales that were likely to require succession planning support in the near future. The research went down to a threshold of £1 million in turnover and considered businesses' financials, ownership and structure. Having stripped out non-indigenous firms, this left a cohort of 3800 firms that are likely to be on the radar of professional advisors, *'spread throughout Wales, with pockets in Mid Wales, Swansea and West Wales'*.

The portrayal of up to an estimated 97% of Welsh SMEs as *'lifestyle businesses'* by one professional advisor interviewee — in the sense of being focused on an owner's livelihood and life project and without an overriding strategic ambition or aspiration of *'building value'*, rather than referring to size — is a further indication of the fact that there is likely to be a large cohort of businesses that are not being catered to by the support on offer from professional advisors. The focus on *'deals'* in the professional community as highlighted by several interviewees reinforces this focus on targeting SMEs with a strong existing strategic proposition for professional succession planning support, because the support role required in a longer process of *'building value'* *'can get time heavy'*, as one interviewee put it.

This is true, even when taking into account that most of the professional firms that are focusing on SME succession planning or are developing their offer to cater to this target group are focusing on the top slice of these 97% rather than the remaining 3% of SMEs (the latter will be serviced well by local branches of large accountancy firms such as the *Big Four*²³).

In view of the results presented in the technical report suggesting that micro-businesses make up a large proportion of the Welsh economy, this leaves a considerable cohort of businesses without access to appropriate succession planning support.

This finding is exacerbated by the fact that 32% of businesses in the survey sample had thought about succession planning (but not acted upon it) and 68% had thought about it *'rarely'* or *'never'*. While some of these businesses without a succession plan suggested that they did not anticipate considering a transfer of ownership in the foreseeable future, a quarter suggested that they had simply not had the time to think about it.

²³ Refers to the four largest accounting firms in the world: Deloitte, PwC, Ernst & Young, and KPMG. These firms provide an extensive range of accounting and auditing services, including external auditing, taxation services, management and business consultancy, and risk assessment and control.

Moreover, the strong incidence of family-owned businesses in the survey sample, many of whom have not considered the details of whether and how ownership of the business will be passed on to the next generation, suggests that targeted support is required for family-owned businesses. Based on an extrapolation of the survey results to the whole business population in Wales, a substantial number of jobs potentially depend on such businesses.

2.4.1 Exploring opportunities for SMEs with strong value to their local economy

The professional advisors interviewed for this study consistently confirmed that supporting the transfer of ownership to a management team through an MBO or MBI formed an integral part of their offer, on occasions recommending this solution where a seller has unrealistic expectations and sometimes following what one advisor described as *'a long walk of disappointment'* while looking for buyers. Alongside this, Finance Wales' portfolio of investments — now formally focused on supporting business succession through the Wales Succession Fund, but even prior to this supporting such transactions where appropriate through other funds — includes a substantial number of MBO succession deals²⁴.

This suggests that support is available where an SME may not have a strong enough proposition for a trade sale or where the vendor and/or the management team initiate a process of considering a Management Buy-Out in order to anchor the ownership and employment associated with the business in Wales. Whether this support reaches smaller businesses with a more idiosyncratic business culture that may well depend on the management team remaining involved in taking the business forward, for instance, is another matter.

In view of the focus on 'deals', the extent to which the scope exists in the current support environment to more explicitly explore opportunities to anchor business ownership and the associated economic activity and employment in Wales is another issue that arises. Most interviewees, while being supportive of including an MBO in an options appraisal, indeed favouring an MBO under certain circumstances, had not actively engaged with the opportunities and requirements of an Employee Buy-Out. The suggestion that few SME owners would have sufficient commitment to their employees' future and aspiration to create a legacy for the local economy to forgo any financial returns may well be indicative of two things: the profile of the cohort of SMEs with which most of the professional advisors would typically work, and the fact that there is scope to strengthen advisors' knowledge of the detailed financial implications of an Employee Buy-Out.

²⁴ According to a Finance Wales interviewee, over 100 transactions to a value of £40m+ and a leverage of private investments of £100 million have been completed in recent years, with an average of 15–20 transactions per year.

2.4.2 Affordability and accessibility of succession planning support for smaller SMEs

Even where this cohort of businesses that may not initially be on the radar of professional advisors themselves proactively identify the need to start planning for succession, the cost of retaining advisors to support them in ‘building value’ may be prohibitive. One accountancy stakeholder described the existing gap in succession planning support as relating to businesses in the £100k to £2m bracket, where *‘the cost effectiveness of a succession deal is questionable’*.

One corporate finance advisor described a client project in which the team (working in partnership with a range of other professional services) was able to *‘double the bottom line’* over the course of a two-year journey that included support for the implementation of the recommendations made. In light of these gains, the monthly retainer paid by the SME is entirely warranted. However, for many SMEs, any potential gains will be of a very different order of magnitude and may not be evident from the start.

Access to support is further likely to be affected for a large majority of SMEs in Wales by the business models adopted by professional advisors. Accountants — identified by all stakeholders as the main group of professionals interacting on a regular basis with SMEs — tend to work on a fee basis, which creates a primarily transactional relationship. *‘They may engage with an accountant for an audit or a set of accounts, but there is unlikely to be any long-term strategic discussion,’* as one interviewee put it. Stakeholders suggested that only larger SMEs with more complex tax arrangements will retain an accountancy firm. Several interviewees also reported that for accountants an SME being transferred to new owners would potentially be seen as a risk of losing clients, which might influence their propensity to raise the issue of succession planning.

Location is a further factor influencing the extent to which succession planning support is easily accessible for SMEs. Stakeholders suggested that much of the dedicated professional advice is concentrated in the South East and the North East of Wales, where it is easy to access accountants, legal advice, etc., stretching into Bristol and Liverpool. *‘The further West you go, the harder it gets to find the right advice.’*

2.4.3 Criteria for a cost–benefit analysis of succession planning support

At the same time, as one interviewee pointed out, there will be SMEs that are genuinely too small or too niche to warrant any succession support. In determining whether there is a case to make additional detailed succession planning support available to any SME, over and above a pure consideration of any turnover brackets, staff numbers or the owner’s age, much will therefore depend on the strategic position of a business. However, as one stakeholder commented, business growth as the key criterion for both the allocation of public sector-sponsored enterprise and business support and interest from financial institutions and investors may not be sufficient in identifying SMEs that are important within their local economic structure. Instead, measures such as longevity and some way of quantifying the customer base should be taken into account in identifying businesses that warrant succession attention and could potentially be turned into a fundable proposition.

2.4.4 Addressing the time bomb

Finally, there is a time-related dimension in identifying any cohorts of SMEs in Wales that may not be catered to sufficiently by the existing support infrastructure. There are two dimensions to this. Firstly, an implicit timeline linked to events was identified by some interviewees, suggesting, for instance, that there will be a cohort of SME owners who might have considered transferring ownership of their business around the time of the financial crisis of 2008 but found that no finance was available at the time. It will have *'taken many SMEs till now to get back on their feet and to find different ways of getting a deal financed'*. Indeed, the picture appears to be one of investment activity picking up considerably, creating new opportunities for SMEs to benefit from fresh investment as part of a transfer of ownership²⁵.

Alongside this, in view of the limitations in the support infrastructure as outlined above, the age structure of SME owners in Wales can be expected to create additional pressures to make succession planning support more widely available to those SMEs that do not, as a matter of course, seek out such support. Analysis undertaken by Finance Wales²⁶ suggests that there is indeed a sizeable cohort of business owners in the 55–70 age bracket (in our survey, 19% of Directors were over the age of 65). However, a 2014 analysis undertaken by PwC suggests that at 56.5 the average age of Directors was lower in Wales than in all other UK nations²⁷.

The findings from the survey as presented in the technical report provide further insight into the need for succession planning in SMEs in Wales. As outlined previously, 32% of businesses in the survey sample had thought about succession planning; in other words, they are likely to anticipate this being of relevance to the business in the near future but have not acted upon it, while 68% had thought about it 'rarely' or 'never'. This would suggest that there are both short-term and long-term opportunities in addressing succession planning in Welsh SMEs in the bracket of 5–50 employees (the sample covered by the survey).

2.4.5 Conclusions

Overall, the picture that emerges is one of a considerable number of SMEs in Wales not being alerted to the need to plan for succession and/or potentially finding it difficult to access or afford appropriate support. And yet, from a public policy perspective, these SMEs have a considerable contribution to make to sustaining the overall vibrancy of the Welsh economy. The notion of 'building value' through a staged process of planning for and implementing a transfer of ownership is likely to be highly relevant to many of these businesses.

²⁵ See Management Buy-Out – The way forward for your business? (2014), Hugh James [https://www.hughjames.com/wp-content/uploads/2015/07/HJSpotlight_MBO_V2.pdf]

²⁶ Using data from <https://custom.onesource.com>, a commercial provider of global company data

²⁷ See Management Buy-Out – The way forward for your business? (2014), Hugh James [https://www.hughjames.com/wp-content/uploads/2015/07/HJSpotlight_MBO_V2.pdf]

One conclusion from this analysis of the nature of succession support available to SMEs in Wales is that it is precisely those slightly larger SMEs and/or those having successfully shaped a strategic niche for themselves that will often be the subject of a trade sale with ownership transferring outside of Wales. While most of the advisors agreed that this is not necessarily a bad thing for the Welsh economy as a whole, one commented that it is precisely the niche businesses or larger SMEs *'that you would want to retain ownership of'*. It is clearly a question that warrants closer inspection.

From this analysis drawing on the stakeholder interviews and the survey results, two main market failures can be identified that prevent SMEs in Wales from taking up optimum levels of succession planning support:

1. A structural market failure exists in the sense that the valuation of a business for a sale or investment proposition may not adequately reflect the value of that business to the local economy in terms of employment and the vibrancy of the local economy.
2. Information-related market failures exist in the sense that owners are not sufficiently aware of the different succession options and their implications and, therefore, do not embark on succession planning at an early enough point in time.

3 Targeting of different SME cohorts

Section Summary

- Wider Welsh Government economic development policy objectives and links to the Wellbeing of Future Generations pledges should be kept in mind in deciding which cohorts of SMEs should be targeted with additional succession planning support.
- A focus on nurturing the kind of entrepreneurial culture that uses strong management disciplines to underpin business growth and to promote the skills base to feed into the overall business stock in Wales can help to reconcile potentially conflicting economic policy objectives.
- A useful segmentation of SMEs in relation to their specific succession planning needs must go beyond an analysis that is purely based on aspects such as the age of owner-managers or company size. While such markers will help to identify businesses that may face succession issues in the near future, limiting the analysis to this level would not be conducive to maximising the possible contribution of a focus on succession planning for the Welsh economy.
- The Scottish model offers a template of how succession planning can be delivered in a way that takes an in-depth understanding of an individual SME's specific situation as its starting point and tailors a response to the particular requirements.

3.1 Considerations in the Welsh policy context

A key consideration in understanding whether and what additional support for succession planning could usefully be made available in Wales and to which cohorts of SMEs is to understand whether and how successful business succession is linked to different economic development goals.

The preceding discussion clearly highlights the fact that there are indeed links to a number of different policy objectives, from strengthening local economies by securing a future for small businesses and retaining the vibrancy of local economies to strengthening productivity and international competitiveness and growing the number of financial transactions, which is seen by stakeholders to be a key staging post in attracting more equity finance to Wales.

Wider Welsh Government economic development policy objectives and links to the Wellbeing of Future Generations pledges should also be kept in mind in identifying the rationale for specific additional supports. Quoting an earlier DTI report, the Wales Co-operative Centre report, for instance, also highlighted the potential implications of business succession planning for wider economic development policy choices as follows:

*'Failed business transfers of potentially viable businesses in areas of high unemployment and low activity rates [...] involve much higher social costs than is the case in more economically buoyant geographical areas, especially when the impact of their closure upon other local firms, regeneration etc. is taken into account. Similar arguments could be made in relation to firms facing business transfer that are located in remote rural areas. The highly localised nature of the market for small firms poses particular problems for such businesses, and business transfer failure can deprive local consumers of a valuable service – leaving alternatives that cost more and/or are less appropriate to local needs.'*²⁸

The reference to social costs that might arise from succession failure also points towards the need to understand what exactly can be gained — or what losses avoided — by making additional succession planning supports available to different cohorts of SMEs in Wales. What is required from a public policy perspective is, therefore, to find the most appropriate response for different businesses and the right mix of outcomes overall. Nurturing the entrepreneurial drive in profit-driven private enterprises to create maximum value in businesses individually and transactional activity more generally, however, is potentially at odds with broader public policy outcomes around economic development, such as retaining ownership of SMEs in Wales or strengthening the voice of employees in business governance through employee ownership.

A number of interviewees suggested that the common ground between these aspirations is to more generally nurture the kind of entrepreneurial culture that uses strong management disciplines to underpin business growth and to promote the skills base to feed into the overall business stock in Wales.

Alongside this, the stakeholder interviews provide a complementary contextual perspective on different SME profiles in relation to succession planning. Considering these in terms of a comparison of exit and succession scenarios and of a discussion of economic growth objectives compared to objectives related to the resilience of local economies can further challenge assumptions and enhances the picture derived from the survey data. A more detailed discussion of these two dimensions is presented in Annex 1.

In summary, we can conclude that a useful segmentation of SMEs in relation to their specific succession planning needs must go beyond an analysis that is purely based on aspects such as the age of owner-managers or company size. While such markers will help to identify businesses that may face succession issues in the near future, limiting the analysis to this level would not be conducive to maximising the possible contribution of a focus on succession planning for the Welsh economy.

²⁸ Wales Co-operative Centre (2012), Employee ownership: Defusing the business succession time-bomb in Wales

3.2 Insights from the Scottish model

As in Wales, strengthening succession planning for SMEs had been identified as a priority in Scotland. In response to concerns about succession planning, the Succession Programme was introduced in 2015²⁹.

Prior to the Succession Programme being introduced as a generic support product, dedicated support had only been available in the context of the Scottish Government's commitment to promoting employee ownership. This formed part of Co-operative Development's remit and was delivered as part of the wider support on offer for co-operative and mutual business models.

Limited success of this approach led to the conclusion that succession planning needed to take an in-depth understanding of an individual SME's specific situation as its starting point and tailor a response to the particular requirements, rather than promoting one particular model. The approach was therefore altered fundamentally by incorporating a broader focus on succession planning into the delivery model. A 'listening' approach now characterises the Succession Programme.

The programme is delivered in two parallel tracks:

1. Succession Expert Support, which makes staged support available to SMEs, with more intensive support available to those wishing to explore employee ownership models;
2. the Succession Programme, which embeds succession planning in the wider portfolio of SME support provided by Scottish Enterprise.

This model delivers a number of results: it creates a clear focus for succession planning and a dedicated port of call for succession planning and ensures that this remains a live agenda item in interactions with all account-managed businesses. Furthermore, it creates a strong interface with the community of professional advisors. As a result, the wider succession planning message is beginning to filter into professional advice more generally.

²⁹ This account is based on an interview with a representative of Co-operative Development Scotland (which forms part of Scottish Enterprise) and a progress report on the Scottish Succession Programme as of 31st March 2017.

4 Conclusions and recommendations

4.1 Conclusions

Succession planning has an important role to play in delivering on economic policy objectives in Wales. The SME survey undertaken for this study confirms that there is a sizeable cohort of SME owners who have not considered succession planning. For those that have given succession planning some thought, the survey provides evidence that many of them would find succession planning support valuable. Tax planning, financial and investment planning and support for transitional processes are top of the list in that respect.

A review of the succession planning support environment which draws on extensive stakeholder interviews suggests that much of the specialised technical support for succession planning as called for by SMEs is available in principle. Feedback from stakeholders also indicates that access to finance is not an issue for SME succession in Wales. While Welsh SMEs are not necessarily on the radar of large equity investors, Finance Wales was seen to go a long way in filling that gap.

According to stakeholders, an issue that frequently arises is SME owners having unrealistic expectations regarding the value of their business and the likelihood of finding a buyer who is willing to pay a 'strategic premium' for the business in a trade sale. A Management Buy-Out was identified by a number of stakeholders as a viable alternative and an opportunity to lead the business towards new growth while allowing the exiting owner to secure adequate financial returns. Awareness of the potential for employee ownership to offer a further alternative for owners wishing to transfer ownership of their business was relatively low amongst stakeholders.

Combining the evidence from the SME survey and the stakeholder interviews suggests that as a result of the business models, skills base and cultural reference frameworks (e.g. a focus on 'deals' rather than business development) that govern the provision of relevant professional services, much of this support targets a particular cohort of SMEs. Key markers of this cohort are a turnover of at least £2 million and a strong strategic outlook that makes them attractive for a transfer of ownership, including a potential trade sale.

This leaves a gap in market-based provision for smaller SMEs and those requiring more intensive support in strengthening their management processes and information as well as their strategic position, a process described by the professional community as 'building value'. The gap identified relates firstly to awareness raising and to nurturing a realistic understanding of different succession options for SMEs and their implications for the exiting owner and the future prospects of the business.

The ability to assess the quality of available support and the potential return from an investment in succession planning support were identified as issues that may prevent many SME owners from seeking out succession planning support. Alongside this, however, affordability was identified as an obstacle for some SMEs in making use of existing professional advice and support. The business models adopted by professional advisors, which mostly hinge on a fee-based transactional relationship, may make it difficult to create the space for the kind of strategic engagement that is required to support SMEs in developing and implementing a succession plan.

Suggesting that the notion of 'building value' is relevant to virtually all SMEs, many stakeholders took issue with assumptions regarding the difference between what is commonly described as an 'exit strategy' on the one hand and 'succession planning' on the other hand. This led many to the conclusion that what is required is a strengthening of narratives around strategic business development as an essential ingredient in SME growth and resilience throughout the business life cycle, from start-up and early growth to maturity and succession planning. Increasing the number of equity-financed transactions in Wales was seen to make a contribution to the entrepreneurial churn required to engender a more dynamic economy, attract further investment and, ultimately, lead to economic growth.

Against this background, identifying SMEs that would warrant public sector-sponsored succession planning support and could potentially be turned into a fundable proposition needs to go beyond simplistic markers such as turnover or the age of the owner(s) and to take into account the business' strategic outlook, its position in the market and its contribution to the local economic fabric.

Finance Wales and the Wales Co-operative Centre have strong visibility in the context of succession planning support for SMEs and were repeatedly identified as agencies that could potentially play a greater role in succession planning, while there is an opportunity for Business Wales to further strengthen the way in which one-to-one interactions with SMEs are levered to communicate such messages to the wider SME community.

4.2 Recommendations

Drawing on the conclusions above, the following recommendations set out how business succession planning support can be promoted and strengthened through the wider Business Wales offer.

Recommendation 1: Develop a clear policy statement regarding the importance of SME succession planning for the Welsh economy. An understanding of SME business life cycles and the need to consider exit or succession planning should be embedded in the narrative around enterprise and business development in Wales.

Recommendation 2: Confirm and enhance the Business Wales offer to support SME succession planning by:

- Embedding a consideration of succession planning requirements in the Business Wales diagnostic tool.
- Determining the most appropriate mix of awareness raising, information, advice and any financial subsidy for specialist succession planning support.
- Adding content on succession planning to the Business Wales web platform, including special reference to the potential challenges of family succession.
- Embedding a focus on the kinds of management disciplines that can help to build up an SME's value proposition for a transfer of ownership over time in all BW advice (e.g. staff engagement, clear management roles, strong management information, transparent contractual relationships).
- Ensuring that all Business Wales advisors have the requisite skills to support general SME succession planning.
- Commissioning one-day business succession awareness-raising workshops for SMEs, making participation in these workshops a precondition for SMEs benefitting from more intensive support.
- Considering whether additional subsidised support should be made available to SMEs and, if so, developing a bespoke assessment tool on the basis of Welsh policy priorities to identify whether publicly sponsored support should be made available to an SME³⁰.

³⁰ This would consider whether a market failure applies to the SME while taking into account: the SME's role as an employer (in the local community and for the Welsh economy as a whole); the profitability and tangible and intangible assets; the position of the business within the industrial structure in the particular sector; and the current growth potential and/or opportunities to lever a refreshed strategic proposition to stimulate growth under new ownership.

Recommendation 3: Build on the existing profile and credibility of the organisations that are currently prominently engaged in the succession planning agenda in Wales by working collaboratively amongst the Welsh Government, Finance Wales, the Wales Co-operative Centre and the professional advisor community to raise awareness of succession planning issues, promoting the diversity of succession options and creating an integrated offer. Key priorities in a collaborative approach should include:

- Running a joint awareness-raising campaign.
- Reaching beyond the existing BW client base by continuing to promote succession planning through intermediaries, professional bodies and professional advisor networks, as pioneered in the Finance Wales approach.
- Working with the professional bodies in Wales to deliver engagement and training to the professional community to strengthen their understanding of and commitment to longer-term support for SMEs to 'build value' while taking into account the whole range of models for a transfer of ownership.
- Where any financial support forms part of the ultimate Business Wales succession planning offer, leveraging this as an incentive for professional advisors to engage with a wider group of SMEs.

Appendix 1 – SME cohorts in the context of policy objectives

The stakeholder interviews provide a complementary contextual perspective on different SME profiles in relation to succession planning, which usefully challenges and enhances the picture derived from the survey data and assumptions underpinning policy objectives. This stakeholder perspective can usefully be presented in terms of two dimensions, namely exit vs. succession and economic growth vs. resilience of local economies.

Exit vs. succession

These two terms were used by some stakeholders to describe the different ways in which owners approach the strategic development of their business. The notion of a planned (early) exit is often associated in public debate with owners' ambition to 'cash in' on a new venture. Focusing on building brand value and/or the visibility and likely future prospects of their technology and knowhow in pursuit of buyers for the business are often seen in policy debates as delivering limited value to the Welsh economy. This is because such a strategy is seen to be focused on a trade sale delivering a maximum return to the owner(s), but not necessarily delivering maximum economic value to the Welsh economy as a whole, particularly seeing that such businesses are frequently bought by international corporates or investors.

Contrary to this view, many stakeholders instead focused on the way in which a planned exit meant that owner-managers adopted an approach of building value in the business from the start, an approach that, by definition, also increases the competitiveness of the business in question and has the potential to increase the business' value to the Welsh economy. In other words, what is described as an exit strategy is essentially what many stakeholders called for in the context of succession planning, namely to consider this to be an essential stage in the overall business life cycle that needs to be taken into account as early as possible.

One stakeholder contrasted businesses with this kind of exit strategy with a much larger cohort of SMEs in Wales that are set up and managed to deliver on the ambitions and plans of the owner(s). Suggesting that up to 97% of SMEs in Wales are likely to fall into the latter category, these were described as 'lifestyle' businesses, regardless of their size. The owner(s) dedicate(s) their life to the business and personifies the business' outlook and culture. In many cases, however, this results in the entrepreneurial energy and strategic trajectory of the business being curtailed where owners run a business over many decades with limited direct (through sharing the governance of the business) or indirect (through a rigorous assessment of the business' strategic position) outside influences shaping the choices being made.

Nurturing more SMEs with the kind of strategic ambition that is required to develop a viable exit strategy can therefore be seen as a way in which to considerably strengthen their overall growth potential. Encouraging owners to focus on building the value of the business from the start, over and above a focus on near-term turnover and profitability, then becomes a key lever in strengthening SME growth, rather than curtailing it (as is often suggested). Not focusing on an exit strategy early enough can arguably result in a growth trajectory that plateaus at some point unless new entrepreneurial energy is invested in the business.

This understanding would suggest that two parallel tracks would be required to enhance business succession planning support in Wales:

- Supporting SME owners that are facing the business succession challenge in the near future in appraising different options and building value in the business over a relatively short period of time (i.e. between three and five years);
- Embedding a focus on nurturing value in the business and anticipating an exit strategy for the owner in the business management discipline across different cohorts of Welsh SMEs.

Economic growth vs. resilience of local economies

Closely linked to the idea of an exit strategy as the optimum way in which to plan for business succession is the question of how objectives relating to economic growth on the one hand and the resilience of local economies on the other hand could and should shape policy choices. The stakeholder interviews suggest that in considering a segmentation of Welsh SMEs in terms of succession planning needs and priorities, a broader understanding of the options that are realistically available in Wales is required.

Underlying such comments is the view that considerable investment is an essential prerequisite for the growth of SMEs into the kind of medium-sized businesses that can experience sustainable long-term growth and make up a Welsh Mittelstand, the medium-sized group of businesses that are historically underdeveloped in large parts of Wales. This kind of investment is seen to primarily come from Venture Capital or successful larger corporate structures that may buy into successful SMEs in Wales and finance their growth.

In the current situation, with limited capital available in Wales, calls to avoid 'selling out' to investors from outside Wales were seen by many interviewees as counterproductive. Instead, many stakeholders called for an approach of stimulating the kind of entrepreneurial churn that would create a cohort of entrepreneurs in Wales with the capital and experience to help build a stronger business base.

A succession planning segmentation of SMEs in Wales on that basis would seek to understand the specific role of different SMEs within their local and the wider Welsh economy and support those with a realistic prospect of realising an external sale alongside others that may need support in considering other options in order to secure their contribution to local economies throughout Wales.

Appendix 2 – The Scottish Enterprise Succession Programme

As in Wales, strengthening succession planning for SMEs had been identified as a priority in Scotland. In response to concerns about succession planning, the Succession Programme was introduced in 2015³¹.

Prior to the Succession Programme being introduced as a generic support product, dedicated support had only been available in the context of the Scottish Government's commitment to promoting employee ownership. This formed part of Co-operative Development's remit and was delivered as part of the wider support on offer for co-operative and mutual business models.

Limited success of this approach led to the conclusion that succession planning needed to take an in-depth understanding of an individual SME's specific situation as its starting point and tailor a response to the particular requirements, rather than promoting one particular model. The approach was therefore altered fundamentally by incorporating a broader focus on succession planning into the delivery model. A 'listening' approach now characterises the Succession Programme.

The programme is delivered in two parallel tracks:

1. **Succession Expert Support:** With the aim of encouraging and supporting succession planning in Scottish SMEs, Succession Expert Support is delivered through a two-stage service free to any Scottish-based business.

The first stage consists in a one-day succession planning consultation with business owners considering all relevant succession options and beginning active succession planning. This results in a report identifying the pros and cons of different succession options for the business in question.

The second stage is available to business owners expressing an interest in employee ownership as a likely or preferred option, and specifically focuses on assessing the feasibility of employee ownership for the respective business. Stage 2 may take between one and two years and will support the business in assessing the costs and benefits of employee ownership, identifying different finance options and considering any grant support that might be available to the business to support the transfer of ownership.

³¹ This account is based on an interview with a representative of Co-operative Development Scotland (which forms part of Scottish Enterprise) and a progress report on the Scottish Succession Programme as of 31st March 2017.

- 2. Succession Programme:** The Succession Programme was launched with the aim of extending Succession Expert Support to the full portfolio of Scottish Enterprise account-managed businesses. Through the programme, Account Managers are supported in identifying SME business owners who should consider accessing Succession Expert Support.

All Account Managers have received training in succession awareness and are encouraged to raise the topic of succession with the identified owners (as and when they consider it to be suitable) and refer them to Succession Expert Support if appropriate.

The Succession Expert Support team then maintains regular 'light-touch' contact with all Account Managers to provide mutual updates on progress regarding company contacts and referrals.

Importantly, the diagnostic used to identify SMEs that would benefit from dedicated succession planning support is based on a contextual assessment of each SME's strategic position and potential to contribute to policy objectives for the Scottish economy as a whole, rather than being based on a data-led segmentation of the market.

The actual support under the Succession Expert Support scheme is delivered by the existing team of advisors from the original Employee Ownership framework, who have all received additional training on employee ownership.

Following Stage 2 of the support, SMEs can apply for a 30% subsidy for further professional support to implement the succession plan and to deliver the actual transfer of ownership. The focus on employee ownership for the subsidised support was introduced based on the conclusion that support for other business succession options was readily available in the marketplace and could be expected to create sufficient private returns to create an incentive for business owners to pay for the services once they are aware of the issues at stake. There was therefore no market failure that would warrant a public subsidy for the actual support.

A wider portfolio of workshops and promotional activities around succession planning, such as feature articles in accountancy magazines, Master classes with accountants and a schedule of business events such as 'Selling your Business' have further contributed to putting succession planning firmly on the agenda.

This model delivers a number of results: firstly, it creates a clear focus for succession planning and a dedicated port of call for all account-managed businesses. Secondly, it creates continuity for interactions between the team overseeing the commissioning and delivery of Succession Expert Support and Account Managers, which helps to ensure that succession planning remains a live agenda item in interactions with all account-managed businesses.

Thirdly, the approach creates a strong interface with the community of professional advisors, from accountants to solicitors, who have identified the programme as a source of revenue. As a result, the wider succession planning message is beginning to filter into professional advice more generally. Even where professional advisors do not directly engage with the programme — which remains the case to some extent for many accountants whose focus continues to be on ‘deals’ — the support being made available creates ‘*informed customers*’ able to source the necessary support and assess the quality thereof.

A summary of the results from diagnostic discussions with the Scottish Enterprise Account Managers indicates that latent demand existed in 21% of SMEs. The progress report as of 31st March 2017 also suggests that referrals by Account Managers into Succession Expert Support have steadily increased since 2014/15 to 37 referrals in 2016/17. With a limited budget, this allows the message of the need for succession planning in general and employee ownership in particular to reach a wide cross-section of SMEs in Scotland. This has been particularly beneficial for more rural areas in the Highlands and Islands, where demand for succession support has proven to be greater than elsewhere in Scotland. This is seen to be indicative of less dedicated support having been available there in the past on the one hand and a different focus in terms of economic policy objectives and a slightly different remit for Account Managers on the other hand.

Without the dedicated Succession Expert Support team, Account Managers had been reluctant to raise succession planning, because they felt that they had nothing to offer were any issues to be identified in that respect. Moreover, accommodating a succession planning discussion in the wider support intervention with SMEs was seen to be challenging. The new structure is seen as highly suitable in overcoming some of these obstacles identified in the previous delivery model, and creates a constantly high profile for business succession planning.

Clearly, this model is a function of the organisational arrangements in Scotland with Co-operative Development Scotland being an integral part of Scottish Enterprise and the Account Management function structuring all interactions with Scottish SMEs. While the programme is open to all SMEs in principle, the latter, in particular, has shaped a focus on the portfolio of account-managed companies in Scotland — a total of between 2000 and 2500 businesses — that are seen to have the greatest potential to contribute to economic growth.

With increasing numbers of referrals, there is clear evidence of benefits being generated for the Scottish economy overall. Nevertheless, a clear choice was made in the Scottish model to prioritise SMEs with growth potential and getting the message out to all SMEs, particularly smaller ones, remains challenging.

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