The Implications of Intangible Assets in SMEs’ “Succession Process”

Susanne Durst MSc

University of Liechtenstein
Chair in International Management
Vaduz, Principality of Liechtenstein

WIPO Regional Symposium on Management of Intellectual Capital, Intellectual Assets and Intellectual Property
October 28-29, 2009 – Hong Kong
Problems of sustaining enterprise knowledge

- Most knowledge is kept in the heads of the owner and some key employees
- Existing know-how is undervalued
- The smaller the company the less it has an overview of the firm’s knowledge
- Only modest measures are introduced to foster knowledge management
- Limited internal resources complicate the issue of knowledge retention / knowledge management
- (Often) centrality of owner-manager. He/she possesses most of the firm’s human and relational capital
Company succession – a brief introduction

- Company succession is the transfer of the property and/or management of a firm from one individual to another (Ip & Jacobs, 2006)
- One third of EU entrepreneurs (primarily company founders) will leave their firms within the next ten years (Commission of the European Communities, 2006)
  - some 690,000 SMEs and 2.8 million jobs will be affected every year
Succession solutions in German SMEs

2005

70,900 SMEs with approx. 678,000 employees waiting to be transferred

- 43.8% To family members: 31,000 companies with some 351,000 employees
- 10.2% To co-workers: 73,000 companies with approx. 72,500 employees
- 8.3% Closed due to lack of successor: 5,900 firms with some 33,500 employees
- 16.5% To external executives: 11,700 firms with about 107,000 employees
- 21.1% Sold: 15,000 firms with about 114,000 employees

(Wallau, 2007)
Challenges arising from management succession planning

- As succession is less frequent in SMEs than in large companies, practical experience is relatively low.
- Smaller pool of talent on which to draw.
- Company succession has implications for all the parties involved and may symbolise an episode of instability.
- The knowledge of the incumbent as well as some key employees may be a source of competitive advantage:
  - Lack of key knowledge after transfer is executed.
- Reality shows that successors are required to learn everything what the company is made of:
  - Loss of valuable time needed for more important activities.
- Dealing with emotional factors between potential successors and the incumbent.
Research on (external) company succession
Starting Situation (I)

- Changes in demographic conditions
  - Increasing number of smaller firms are waiting to be transferred
  - Reduced pool of appropriate successor
- Decline in the number of family successions (Kerkhoff, Ballarini & Keese, 2004)
- Lack of entrepreneurial culture (European Commission, 2006)
  - Potential (external) successors are key
    ➔ Investor market
Starting Situation (II)

- "Globalization" and "information technology" have triggered dramatic changes in the structure of companies.
- Shift from tangible to intangible resources.
- Intangible assets are defined as the core non-monetary value drivers - lacking physical substance – contributing to future benefits in SMEs (based on Andriessen (2004), Lev (2001)).
- Intangible assets are regarded as the key resources a potential investor is looking for (Nonaka, Toyama & Konno, 2001).
- However, the succession literature seems to have a focal point on legal, financial, tax and family related issues (Morris, Williams & Nel, 1996). With the latter the standpoint of the incumbent seems to be of the highest interest.
- In the case of non-family succession the question of CEO succession in large companies has attracted most attention (Bagby, 2004).
What role do intangible assets play in SME succession processes as seen from the perspective of prospective external successors?
<table>
<thead>
<tr>
<th>Framework</th>
<th>Human capital</th>
<th>Structural capital</th>
<th>Relational Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gallego &amp; Rodríguez (2005)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Claessen (2005)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Alwert &amp; Vorsatz (2005)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>BMWA (2004)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Bontis (1998)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

- **Human capital**
  - employees
  - owner

- **Structural capital**
  - innovative capability
  - company culture
  - knowledge management
  - organizational structure

- **Relational Capital**
  - customers
  - networks
Research Design (I)

- Strategy of inquiry
  - Sequential mixed methods approach

- Unit of Analysis
  - 135 German trade associations (trade corporations and chambers of commerce)
  - Ten external successors of German SMEs

- Sampling
  - Associations: databases provided by parent companies
  - Successors: with the assistance of German associations
    - Following the SME definition of the European Commission
    - Successors have acquired the entire or a significant share of the company
    - No family succession
Research Design (II)

- Data collection
  - Questionnaire
    - online
  - Series of in-depth interviews
    - guided interview approach

- Data analysis
  - Priority was given to qualitative study
Quantitative Findings (I)

- Inhomogeneity prevails regarding the relevance of intangible assets

<table>
<thead>
<tr>
<th>Items</th>
<th>N</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of intangible assets of the company value</td>
<td>50</td>
<td>29.4</td>
<td>19.94</td>
</tr>
<tr>
<td>Relevance of IA within associations</td>
<td>49</td>
<td>2.84</td>
<td>1.028</td>
</tr>
<tr>
<td>Relevance of IA to their members</td>
<td>50</td>
<td>2.94</td>
<td>0.935</td>
</tr>
<tr>
<td>Influence of IA on successor’s decision-making</td>
<td>49</td>
<td>3.27</td>
<td>0.93</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Group comparison</th>
<th>N</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Chambers of commerce</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Percentage of IA of the company value</td>
<td>20</td>
<td>35.5</td>
<td>23.5</td>
</tr>
<tr>
<td>Relevance of IA within associations</td>
<td>19</td>
<td>3.05</td>
<td>1.079</td>
</tr>
<tr>
<td>Relevance of IA to their members</td>
<td>20</td>
<td>3.15</td>
<td>0.988</td>
</tr>
<tr>
<td>Influence of IA on successor’s decision-making</td>
<td>19</td>
<td>3.32</td>
<td>0.946</td>
</tr>
<tr>
<td><strong>Trade corporations</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Percentage of IA of the company value</td>
<td>20</td>
<td>25.5</td>
<td>18.2</td>
</tr>
<tr>
<td>Relevance of IA within associations</td>
<td>20</td>
<td>2.65</td>
<td>0.988</td>
</tr>
<tr>
<td>Relevance of IA to their members</td>
<td>21</td>
<td>2.81</td>
<td>0.873</td>
</tr>
<tr>
<td>Influence of IA on successor’s decision-making</td>
<td>20</td>
<td>3.35</td>
<td>0.933</td>
</tr>
</tbody>
</table>

Five-point Likert scale ranging from 'unimportant' (1) to 'very important' (5)
Quantitative Findings (II)

- Customers, owner, and innovative capabilities seem to be of higher importance

<table>
<thead>
<tr>
<th>Intangible items</th>
<th>N</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner</td>
<td>51</td>
<td>3.94</td>
<td>0.95</td>
</tr>
<tr>
<td>Employees</td>
<td>51</td>
<td>3.37</td>
<td>0.89</td>
</tr>
<tr>
<td>Culture</td>
<td>50</td>
<td>3.18</td>
<td>0.96</td>
</tr>
<tr>
<td>Organizational structure</td>
<td>51</td>
<td>3.12</td>
<td>0.97</td>
</tr>
<tr>
<td>Knowledge Management</td>
<td>51</td>
<td>3.41</td>
<td>1.04</td>
</tr>
<tr>
<td>Innovative Capabilities</td>
<td>51</td>
<td>3.84</td>
<td>0.97</td>
</tr>
<tr>
<td>Networks</td>
<td>51</td>
<td>2.92</td>
<td>1.00</td>
</tr>
<tr>
<td>Customers</td>
<td>50</td>
<td>4.04</td>
<td>0.95</td>
</tr>
</tbody>
</table>

Five-point Likert scale ranging from ‘unimportant’ (1) to ‘very important’ (5)
Qualitative findings (I)

- Intangible assets seem to have a remarkable influence on the external successor’s business acquisition intentions
  - Owners were mainly regarded as a negotiation partner not as an asset
  - Employees or other critical stakeholders were not involved in succession issues
  - Networks and innovative capabilities were of less importance
  - Customers were regarded in view of dependency not as partners
  - New intangibles emerged:
    - Partner
    - Brand
    - Style (Design)
    - Strategy
    - Quality
Critical assets from the (external) successor’s standpoint
Role of ICM in addressing the challenges

- First and foremost, recognition of the importance of succession planning
- Dealing with succession is a process rather than an event
- Adding of consultants
- Stronger integration of the IC aspect into SMEs’ succession process
- Stronger focus on the strategic dimension of intangible assets
- Increased activities on findings ways to transfer (tacit) knowledge (and also using them)
- Implementation of appropriate means to store and disseminate knowledge
  - Increased meaning of succession planning