Family Businesses in Europe
Opportunities and Challenges

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Executive Summary
Relevant issues for family businesses

Family businesses make a large, yet not appropriately represented, part of Europe´s economy. They make-up approximately 60% of Europe´s private sector businesses and represent 40-50% of all Jobs[1]. Family businesses operate in almost every sector of the European economy and encompass a vast range of firms of different sizes. Family business are Europe's best potential for new jobs and growth. Below European Family Businesses highlights the crucial areas that need to be addressed to help family businesses fulfil that role.

Business Transfer
Far too many companies are lost or sold annually due to either a lack of preparation by business owners or disadvantageous tax regimes. Family businesses must have a fair and simple administrative and fiscal transfer of business environment to ensure that companies and jobs are not needlessly lost. European Family Businesses calls for further measures to improve the family business transfer environment which give the companies more legal certainty, which reduce administrative burdens, and ultimately enable family entrepreneurs to grow and create jobs for the long-term.

Strengthening Equity
The use of equity, in particular retained earnings, is often treated unfavourably by many European tax codes. This has led to a situation where companies have become over reliant on debt financing. Member States, with the support of the European Union, must correct the "debt bias" to ensure that equity enjoys the same fiscal treatment as debt.

Sustainable Growth and Innovation for Family Businesses
Promoting private investment, improving regional development, boosting job creation and reducing over-regulation in the EU are rightly high on the political agenda. Therefore, if policy makers are serious about achieving this goals, they must recognize that existing companies, in particular family businesses, represent the greatest potential for growth in the EU.

Presence and Contribution
Any long-term policy targeted towards the support of Europe's family businesses, must be underpinned by a general institutional recognition of this form of enterprise. The EU and its Member States would enable policy makers to effectively address the distinct challenges faced by family businesses and improve the business environment according to their needs.

[1] Mandl "Overview *on Family Business Relevant Issues "Study* on behalf of the European Commission, Vienna 2008

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Relevant issues for family businesses

The purpose of this paper is to outline the types of improvements in the legal, fiscal and educational environment in the European Union that would be conducive to continuity, renewal and sustainable growth in family businesses, the most important and predominant type of economic entity in the European private sector.

Advantages of the Family Business model

Family businesses make a large, yet not appropriately represented, part of Europe´s economy. They make-up approximately 60% of Europe´s private sector businesses and represent 40-50% of all Jobs[2]. Family businesses operate in almost every sector of the European economy and encompass a vast range of firms of different sizes.

There is no doubting the importance of family businesses, not only for what they represent to the economy, through their vital contribution to employment, but also for the personal commitment they show to local and regional communities, the long-term stability they bring, the responsibilities and risk they take as owners, and the values they stand for. As the 2015 European Parliament family business resolution recognises, '**family businesses are the single biggest source of employment in the private sector and that therefore what is beneficial to continuity, renewal and growth in the family business sector is conducive to continuity, renewal and growth in the European economy'**[3]

Family businesses are often managed and financed in a sustainable way. Because they do not suffer from the same pressure to deliver positive quarterly earnings or top line growth as companies with dispersed ownership, their strategy can be long-term. In addition, because they are managed and owned without the intention to sell, they are more conscious and willing to invest in the idea of sustainability, whether it be from the ecological or business perspective[4]. As such, family businesses are the natural partner for governments to implement sustainable business practices. Finally, because of this long-term outlook, family businesses are more willing to invest in innovative technologies as they can be patient on the return of their investment.

Family businesses also represent the largest pool of entrepreneurial potential. Many family companies act as 'start-up incubators': within their sphere of influence they create an ecosystem of expertise and financing opportunities for budding entrepreneurs. Family businesses also support young start-up firms by directly investing in their growth/scaling-up phase[5]. In addition, by creating an entrepreneurial culture within the businesses, at all levels, many family businesses spawn new businesses as employees have the support to create their own enterprises. Finally, family businesses are natural incubators for future entrepreneurs and

[2] Mandl "Overview *on Family Business Relevant Issues "Study* on behalf of the European Commission, Vienna 2008
[3] European Parliament resolution of 8 September 2015 on family businesses in Europe (2014/2210(INI))
[4] Built to last, Family businesses lead the way to sustainable growth, 2012
[5] Die Familienunternehmer-ASU 4th Quarterly Survey 2015

innovation, as family members are regularly exposed to the day to day workings of a business.

Challenges

Certain challenges stem from the environment in which companies operate, e.g. policy makers are not fully aware of the specificities of family businesses and their economic and social contribution; financial issues related to gift and inheritance tax, access to finance without losing control of the firm, favourable tax treatment of reinvested profits. Some are related to the family firm's internal matters e.g. unawareness of the importance of planning company transfers early; balancing the family, ownership and business aspects within the enterprise; difficulties in finding and retaining a skilled workforce. Other issues regarding education and research impact on both the environment and internal matters, e.g. (lack of) entrepreneurship education, and the need for more research into family-business-specific issues.

Thanks to the work undertaken by the European Parliament and the European Commission and academic research, a better understanding of this essential sector is slowly starting to unravel. But, **currently, awareness and understanding of family businesses by policy makers remains incomplete**. It is important, for the EU and its Member States to improve their knowledge of ownership and how it affects the business behaviour of companies in general. **Ownership is key to the business life of a company**. Taking the 'ownership perspective' rather than the 'company size' perspective can help improve understanding of why family companies are more resilient[6] and perform better than their non-family business counterparts[7]. Taking the 'ownership perspective' also leads to a better understanding of the personal risk that entrepreneurs take with their own funds. In addition, the EU and its Member States are rightly concerned with the creation of new companies. However, there is a perception by the business community that **existing companies are not sufficiently supported by policy makers**. Family business continue to be Europe's best potential for new jobs and growth. Below European Family Businesses highlights the crucial areas that need to be addressed to help family businesses fulfil that role.

Business Transfer

Far too many companies are lost or sold annually due to either a lack of preparation by business owners or disadvantageous tax regimes. Family businesses must have a fair and simple administrative and fiscal transfer of business environment to ensure that companies and jobs are not needlessly lost. European Family Businesses calls for further measures to improve the family business transfer environment which give the companies more legal certainty, which reduce administrative burdens, and ultimately enable family entrepreneurs to grow and create jobs for the long-term.

One of the key challenges for any family business is the transfer of the business to the next generation, as highlighted in the European Commissions' Entrepreneurship 2020 Action Plan, 'Transferring a business from one generation to the next is the defining feature of a family

[6] Harvard Business Review What can we learn from Family Business, November 2012
[7] Banca March Value Creation in listed European family firms (2001-2010), 2013

business and the greatest challenge that it can face[8]. The family business transfer is not a single event, it has to be understood as a process, demanding preparation and support. Indeed, the challenges often associated with family business transfer have two distinct origins, the regulatory environment, and preparation.

Research has shown that the certain family businesses **are not sufficiently prepared for the transfer**. Only 16 percent of all family businesses and only 25 percent of the family businesses with a CEO older than 65[9], have a robust succession plan. In addition, in Central and Eastern Europe, where many family businesses are in their first generation, the problem is even greater.

The other major challenge regarding family business transfers is the regulatory environment. For example, the general fiscal framework across Europe is generally favourable to family businesses. However, significant challenges remain. For example, the range of reliefs and exemptions countries offer can mean the effective tax rate can be significantly different to the headline rate. For example, a family business which is not sufficiently aware or unprepared can face severe fiscal obligations that can lead to the closure or the forcible sale of the business[10]. In general, there is still much that can be done to improve the regulatory environment for family businesses who wish to operate across generations.

In accordance with this, **European Family Businesses calls for measures from the EU to support and facilitate business transfers.** The European Commission, should support family businesses in this process by measures which would induce the early preparation of a transfer such as family business specific education, the promotion of best practices and one-stop-shops. The European Commission should take the lead in **promoting best practices** in this field and facilitating the link between the academic and business world to support the development of innovative succession models. The European Commission should furthermore encourage the establishing of **one-stop-shops for business transfers** allowing family businesses to access all necessary information in one place. The European Commission should also **support family business specific education**, including specific family business issues such as succession and family governance into entrepreneurship education to better prepare future entrepreneurs to successfully run their businesses. Introducing these measures will allow to effectively address the transfer challenge of family businesses.

Strengthening Equity

The use of equity, in particular retained earnings, is often treated unfavourably by many European tax codes. This has led to a situation where companies have become over reliant on debt financing. Member States, with the support of the European Union, must correct the "debt bias" to ensure that equity enjoys the same fiscal treatment as debt.

Many National, European, and global institutions (Institute of Fiscal Studies, European

[8] COM (2012) 7985 final
[9] PWC "Biannual Family Business Survey 2014"
[10] EFB&KPMG "Tax Monitor", 2014 http://www.europeanfamilybusinesses.eu/uploads/Modules/Publications/efb-kpmg_european-tax-monitor_efb_final.pdf

Commission, IMF and OECD) have performed studies on the impact of tax codes and their role in how companies finance their operations. They have shown that **most tax codes contain a bias to the advantage of debt finance** and to the disadvantage of equity.

Put simply, **financing a business with equity is discriminated by the tax regimes of most member states when compared to debt financing**. For family businesses in particular, who tend take a more long-term approach, this distorts competition and reduces investments. Family businesses tend to finance large proportions of their investments in reinvesting equity in order to be independent from financial institutions. A recent Commission Working Paper[11] on taxation has highlighted that 'the welfare impact of this bias (debt bias) is relatively large as capital is misallocated by tax arbitrage (both between jurisdictions and types of financing) and risks are exacerbated by increased leverage and probability of default.'

European Family Businesses believes that the remedy would be **to implement a tax system that does not favour debt and other forms of investment over equity but creates a level playing field for all forms of savings and all types of owners.** As high private and public indebtedness continues to threaten the whole European Union, a level playing field for equity would also contribute to a more stable European economic system.

The European Commission has shown that it is starting to address the issue, with the proposed Common Consolidate Corporate Tax Base (CCCTB), its Communication on the Long-term financing of the European Economy[12] and various publications by DG Taxation[13]. It is important that any recommendations proposed by the EU, regarding this issue, must take into account **the millions of family businesses who would benefit from an allowance for equity in the tax code.**

The long-term financing of the European Economy and improving access to finance are issues that are rightly taking centre stage in Europe. The European Union must play an active role in ensuring that the issue of taxation, and in particular, the treatment of long-term equity is being addressed as a matter of fair competition. European Family Businesses calls on the EU **to continue highlighting the distortionary effect of the debt bias by research and dissemination to member states**, and recommending them to reform their corporate taxation regime in favour of financing via equity.

Sustainable Growth and Innovation for Family Businesses

Promoting private investment, improving regional development, boosting job creation and reducing over-regulation in the EU are rightly high on the political agenda. Therefore, if policy makers are serious about achieving this goals, they must recognize that existing companies, in particular family businesses, represent the greatest potential for growth in the EU.

[11] Taxation Paper No 33 (2012): The Debt-Equity Tax Bias: consequences and solutions. Written by Serena Fatica, Thomas Hemmelgarn and Gaëtan Nicodème
[12] Communication on the Long-Term Financing of the European Economy, European Commission 2014
[13] http://ec.europa.eu/taxation_customs/common/publications/studies/index_en.htm

Research has shown that existing companies contribute more to growth and employment when compared with start-ups[14]. Therefore, European Family Businesses **calls on the EU to further investigate and support the sometimes dormant growth potential in existing businesses,** which means broadening support schemes for so that all types of companies regardless of size or age can benefit from them. [15]

It should be noted that the existing design of business supports for SMEs might incentivize businesses to stay below a certain size and therefore restrain growth to still benefit from legal, administrative and fiscal support. Indeed, the creation of a medium sized category could act as a transitional step to aid SMEs who have the potential and willingness to grow. **European Family Businesses would welcome considerations by the EU on a European Mittelstand as a category apart from SMEs which focuses on long-term ownership, sustainability, innovation, local commitment and growth potential.**

European Family Businesses would welcome considerations by the EU on support measures to help SMEs become mid-caps, and mid-caps to become large businesses. In general, along with the focus on SMEs, **the EU should support businesses who are entrenched with long-term ownership, a local connection and latent growth potential.** Family companies often create internal share holder agreements to cement the long-term commitment of the family to the business. These agreements can often put constraints on the business and as such family companies who undertake a long-term commitment should be supported accordingly over the long-term by local authorities.

Presence and Contribution

Any long-term policy targeted towards the support of Europe's family businesses, must be underpinned by a general institutional recognition of this form of enterprise. The EU and its Member States would enable policy makers to effectively address the distinct challenges faced by family businesses and improve the business environment according to their needs.

European Family Businesses calls on the EU to take the lead **in pushing for an institutional recognition** of the family business. Indeed, the EU should actively seek to monitor the interests of family businesses, in periodic reports and studies, coupled with coordinated policy measures as well as to set up a **high level group for family businesses**. In addition, this must be complemented by the continued endeavour **to find a (statistically) operational definition of family businesses** to legitimize the concept and to lead to evidence based policy support. The 2009 expert group proposed a family business definition[16], however this version proved to be

[14] Facilitating Business Transfers, DG Enterprise and Industry, 2012
[15] Durant et al. 'Doing More with Less: Innovation Input and Output in Family Firms', Academy of Management journal, 2014
[16] A firm, of any size, is a family business, if:
- The majority of decision-making rights are in the possession of the natural person(s) who established the firm, or in the possession of the natural person(s) who has/have acquired the share capital of the firm, or in the possession of their spouses, parents, child or children's direct heirs.
- The majority of decision-making rights are indirect or direct.
- At least one representative of the family or kin is formally involved in the governance of the firm.

statistically unworkable and inoperative.

European Family Businesses welcomes the European Commission pilot satellite account for the compilation of family business data, but the project will not cover the whole of the EU 28. European Family Businesses emphasises the need for the EU to promote the gathering of data by all the 28 Member States, and the European Commission should support this endeavour.

Through these actions the EU would ensure recognition and boost awareness of the family business sector. These actions would enable policy makers to effectively address these challenges and strengthen the business environment where family businesses operate. It is no surprise therefore that certain member states are actively seeking to create a legal business form for the family business17.

At the European level, European Family Businesses **calls for the introduction of a Family Business** chapter within the existing SME Test. The existing SME test, although valuable, does not take into account the distinctive features of family businesses which do not necessarily depend on their size. Indeed, legislation concerning taxation, governance, or company law often has a distinct effect on family businesses, their owners and their competitiveness.

Finally, European Family Businesses believes that the European Commission should produce **a communication on family business** that helps to highlight the challenges and opportunities of this important sector for the European economy by 2020. The communication should encompass all the challenges and opportunities of the sector and lay out a long-term strategy for the support of this crucial sector.

European Family Businesses is a federation of 13 national family businesses associations. Our aim is to make political decision makers aware of the contribution of family businesses to society at large and to promote policies that are conductive to long term entrepreneurship. Our members represent turnover in excess of one trillion Euro, equating to 9% of European GDP.

- Listed companies meet the definition of family enterprise if the person who established or acquired the firm (share capital) or their families or descendants possess 25% of the decision making rights mandated by their share capital.

[17] A notable example of a Member State legally recognizing family business as a separate business entity is the family business act in Malta. The act shall contain a definition of family businesses to capture data. The primary function of the act is to facilitate business transfers, by lowering the tax burden, and offering consultancy to simplify the transfer.