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## Major family businesses in Germany

### Facts, figures, potential

Carried out by the Institut für Mittelstandsforschung Bonn

2012 Spring Survey

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## Contents

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<b>Summary</b>	<b>5</b>
<b>1. Introduction</b>	<b>7</b>
<b>2. Survey design and description of the family businesses surveyed</b>	<b>8</b>
<b>3. Current economic situation</b>	<b>12</b>
<b>4. Financing instruments and forms of finance</b>	<b>14</b>
<b>5. Corporate governance and company constitution</b>	<b>16</b>
<b>6. Advisory boards in major family businesses</b>	<b>21</b>
<b>7. Company succession</b>	<b>25</b>
<b>8. Outlook 2012</b>	<b>29</b>
<b>Bibliography</b>	<b>31</b>



## Summary

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- At the start of 2012, within the framework of “The major family businesses in Germany” study series, 408 of the 4,400 major family businesses in Germany with annual turnovers of more than 50 million euros provided representative information on the following **subjects: the present and future economic situation, current and future finance preferences, principles behind company management of family businesses and company succession.** Approximately 58% of the family businesses surveyed belong to the industry sector, somewhat more than 28% to commerce and 14% to the service sector.
- **In 2011 family-owned industrial firms** accounted for a disproportionate **export quota of 42.5%.** Family-owned firms also made above-average investment in research and development. In 2011 their **R&D expenditure ratio** was approximately **4.6%.**
- At the start of 2012 almost three quarters of major family businesses evaluate their **own economic situation as very good or good.** For the majority of major family businesses the **national debt crisis is at present not having any negative effect** on business operations.
- Major family businesses consider retained earnings and write-offs as the most important basis of financing the business. **Bank loans** continue to remain the **most important (external) finance building block** for the business. At present, alternative finance forms such as capital market instruments, mezzanine and venture capital play a minor role for the vast majority of the family businesses. In the future major family businesses are planning to finance themselves **even more from within based on an even stronger foundation** of their own capital.
- **More than half** of major family businesses are in the hand at least of the **third generation.** In approximately 85% of the companies questioned at least one member of the owner’s family/families is actively engaged on its board. The **unity of ownership and management** is therefore still not the exception in major family businesses but the rule.
- The most important **management principles** in the family businesses are: **the securing of the family business and orientation at long-term goals.** More than one third of major family businesses have set down their **management principles in writing in a corporate governance.** In doing this the companies have orientated themselves on their own beliefs.
- **A third** of the family businesses has a **board** on which the owner’s family/families is/are strongly represented as are other business people. On the whole, the work of the boards is regarded as very positive.
- In approximately half of major family businesses the business is due to be handed on to the next generation within the foreseeable future. Here an important aim is to keep the family enterprise 100% in the family’s possession. There are also clear **preferences in terms of succession solutions within the family.**
- In the current year major family businesses also have a good economic position as a starting point. For this reason they will not only be increasing recruitment in **Germany** but also **investing more** in Germany.



# 1. Introduction

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The large German family businesses are increasingly moving in line with public interest. For this reason the Bundesverband der Deutschen Industrie e.V. and the Deutsche Bank AG 2009 commissioned the Institut für Mittelstandsforschung Bonn with a long-term study series with four main goals.

First of all, the task was to identify major family businesses in Germany and to record them in a database. An enterprise was included in the group of the largest family businesses in Germany if a maximum of three families maintain at least 50% of the shares in this business and the company generated an annual turnover of 50 and more million euros. Using this definition around 4,400 economically independent large family businesses with the parent company's headquarters in Germany were identified.<sup>1</sup>

On the basis of this foundation total, a further goal of the study series consists in finding out the significance for the economy of major family businesses. On the whole in 2009 major family businesses generated almost a fifth of the total turnover of all German companies and employed more than a seventh of all employees in Germany. The development in the recruitment record of major family businesses is also worthy of note. Despite dropping turnover figures during the economic and financial crisis major family businesses increased their staff. On balance the growth in employee numbers in the years 2007 to 2009 amounted to 3.6% and was thus greater than the growth in employment in Germany as a whole.<sup>2</sup>

Within the framework of the study series, which has been set up with the longer term in mind, balance sheet as well as profit and loss data will be regularly analysed for major family businesses. The studies so far have shown that major family businesses have outstanding balance sheet and profitability figures.

Using the database produced within the framework of the studies so far it was only possible to analyse the economic significance as well as the balance sheet or profit and loss accounting data. Only limited conclusions on the nature and extent of the use of production factors in the firms

and future challenges are possible with an analysis of the figures. In order to be able to answer such questions, at the beginning of 2011 an empirical survey targeted at certain subjects was carried out with approximately 400 of major family businesses. The emphasis in that survey was on the globalisation of major family businesses.

At the start of 2012 another survey was carried out on 408 of the 4,400 largest family businesses, the results of which are depicted in what follows. First of all, major family businesses give their estimation of the current economic situation as well as of the effects of the euro crisis on their business position (cf. chapter 3).

Chapter 4 looks at to what extent major family businesses make use of the diversity of finance instruments or will make use of them in future. Central to chapter 5 are the principles behind the management of these companies as well as the capturing of these principles in a governance structure. In the meantime, many family businesses have the support of a board in running the company. The extent, composition and the tasking of these boards are analysed in chapter 6. A very important and continually recurring theme for family businesses is the settling of the succession question for the firm. In chapter 7 the study looks at, amongst other things, what percentage of the firms has already settled the succession question and which solutions the family businesses are aspiring to in settling the succession question. To conclude, the view of the current 2012 business year then follows in chapter 8.

Before the detailed study results are presented, in chapter 2 there will be a short description of the participating family businesses, which we would like to thank most sincerely here for their support.

<sup>1</sup> see Lamsfuß/Wallau (2011), p. 2ff.

<sup>2</sup> see Lamsfuß/Wallau (2011), p. 11ff.

## 2. Survey design and description of the family businesses surveyed

The 2012 spring survey was based on a representative sample from the database created in autumn 2011 of the 4,387 largest family businesses in Germany. The firms were interviewed by TNS Emnid primarily using 15-minute telephone interviews (CATI) from 12 January to 09 February 2012. In addition, it was also made possible for the participants to take part in the study using a web-based CAWI online survey if they preferred. In total, 142 of the 408 participants opted for the online variant, 256 for the personal telephone interview and ten gave their answers by fax.

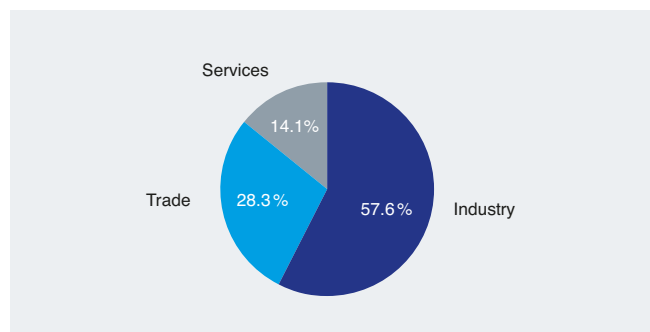
### The sample surveyed is representative of major family businesses

The design of the study enables a comparison of the survey results with the balance sheet and profit and loss data for major family businesses in Germany. In 2009 the 408 firms surveyed had an average equity ratio of 35.2%. Almost the same figure was produced in autumn 2011 using the balance sheet and profit and loss analysis on all 4,400 of the largest family enterprises (33.5%).<sup>1</sup> Since the other balance sheet and rate of return figures give a similar story, the answers of the 408 family businesses interviewed provide a representative selection of the approximately 4,400 major family businesses.

### Majority of major family businesses active in the industry sector

Approximately 58% of the participating 408 family businesses are from the industry sector, somewhat more than 28% in commerce and 14% in the service sector. GmbH [limited company] at 42.6% and GmbH & Co. KG [joint stock company] at 41.1% are the legal forms that predominate when the companies are viewed on this basis. Every eleventh company is run as an AG [corporation].

### The family businesses surveyed according to business sector



n = 406

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<sup>1</sup> see Lamsfuß/Wallau (2011), p. 16.

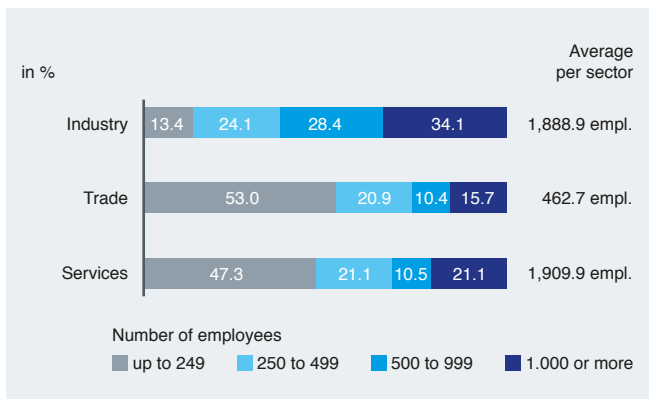




### On average 1,500 employees in 2011

The firms questioned had on average 1,486 employees worldwide at the end of 2011 (median<sup>1</sup>: 450 employees).<sup>2</sup> When divided up according to the three main sectors the picture is as expected: The average employee number in commerce is lower than in the other branches due to the higher turnover per employee. Thus major family businesses in the commercial economic sector have on average 463 employees, in contrast in the fields of industry and service, there are on average 1,900 employees. A few very large firms heavily skew the average for the service sector.

#### Employees 2011 according to sector



n = 404;  $\bar{x}$  = 1,485.9; median = 450

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In total more than one in four of the companies surveyed employed more than 1,000 members of staff at the end of 2011. On the other hand, just under 30% of major family businesses have fewer than 250 employees worldwide. Of these firms more than one in two is active in commerce.

### Jobs in the largest family companies are important for Germany

Major family businesses employ – unlike many of the companies listed in the DAX – now as before the greatest part of their employees in Germany. The average firm in the sample employs approximately 897 of its total 1,486 staff in Germany. This equates to approximately 60%.

When analysed according to the percentage of employees abroad, a differentiated picture arises in line with the sector. Approximately 40% of the family company surveyed employ their staff only in Germany. These firms mostly belong to the commerce and service sectors. In the commerce sector only every third family business employs staff abroad in addition to those in Germany, in the service sector this percentage is somewhat higher at 42%. With the family businesses in the industry sector the opposite is true. Here approximately 75% have employees abroad. In keeping with an above-average export quota as well as a multiplicity of sales and service sites and, in part, production sites also abroad, it is a logical consequence that out of the approximately 1,900 employees of an average industrial family business about 900 are employed abroad.<sup>3</sup>

In general it is noticeable that those family businesses that have high employee numbers worldwide also tend to have a larger workforce abroad. Thus in companies with 1,000 or more employees worldwide, in 60% of the cases more than 500 employees are abroad.

<sup>1</sup> The median is that value under which 50% of the values measured/cases are found in a distribution. In contrast to the arithmetic mean, the median has the advantage of being less affected by so-called outliers, that is, extremely high or low values.

<sup>2</sup> These values lie very close to the values produced in autumn 2011 for all approximately 4,400 of the largest family enterprises, see Lamsfuß/Wallau (2011), p. 13.

<sup>3</sup> The main explanation might be the different degree of globalisation in the economic sectors. Thus the 2011 Spring Survey with globalisation as its main emphasis showed that the industrial family enterprises have a clearly higher degree of globalisation, see Boerger/Lamsfuß/Wallau (2011), p. 13ff.



**Turnover 2011**

In 2011 the family businesses surveyed generated a world-wide turnover of 324.6 million euros (median: 125 million euros). In 2011 a good third of those surveyed had an annual turnover of under 100 million euros, a further third from 100 to 250 million euros and just under 30% an annual turnover of 250 and more million euros.

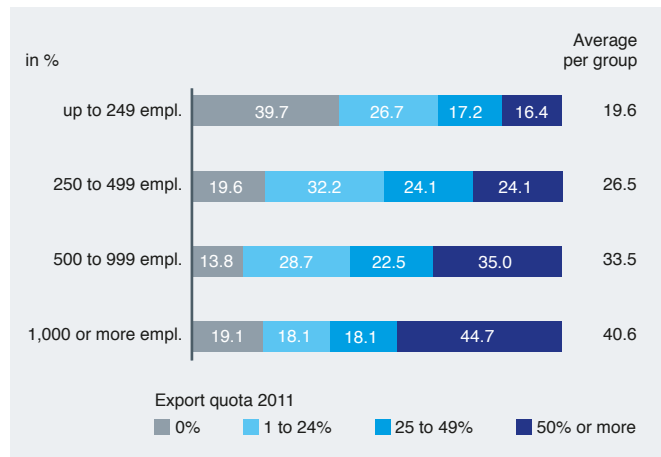
**In 2011 family businesses in the industry sector had very high export ratios**

Here the export of products and services constitutes a substantial portion of turnover for many of the family businesses surveyed. Taking the family businesses surveyed as a whole, the average export ratio in 2011 was approximately 30%. Almost a third of major family businesses even had an export ratio of more than 50%, whilst at the same time approximately a quarter of the firms did not turn over a single euro on foreign markets.

In line with expectations it is predominantly industrial family businesses that can be found amongst companies with the strongest export figures, achieving 43% as the highest export ratio. In contrast, particularly in the commercial and service sector, many family businesses are currently not engaged in operations abroad.

Along with the sector, the size of the company has a bearing on the export ratio. This means that family businesses with fewer than 250 employees had an average export ratio of 19.6%, whilst family businesses with more than 1,000 employees achieved an average export ratio of more than 40%.

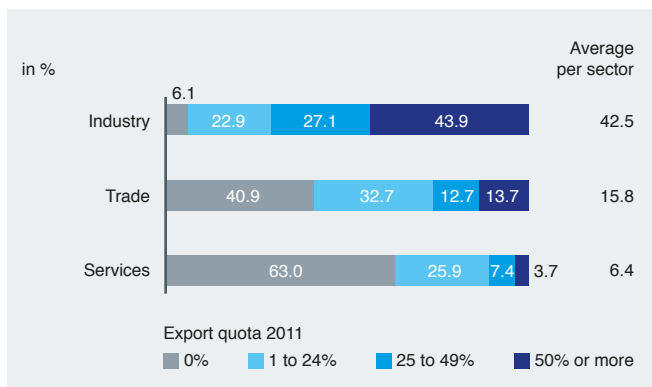
**Distribution of the export ratios in 2011 according to employee numbers**



n = 377; Ø = 29.6%; median = 23.0%

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**Distribution of the export ratios 2011 by sector**



n = 378; Ø = 29.6%; median = 23.0%

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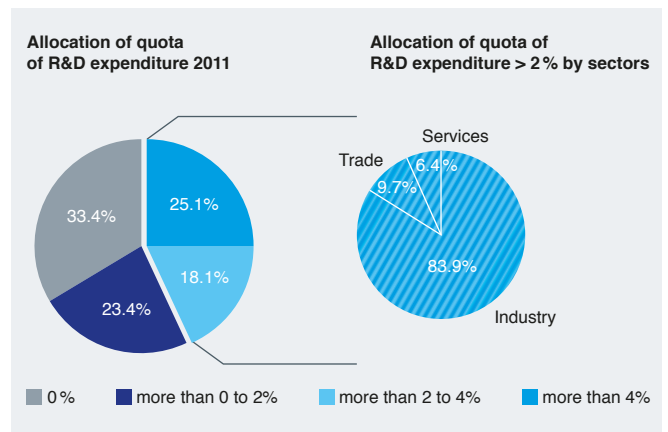


**Family businesses in the industry sector make above average investment in research and development**

The expenditure on research and development (R&D) is an important indicator, even if not the sole one, for the innovation tempo of a company or economy. The higher the expenditure, the greater the prospects of a dynamic development in productivity, improved competitiveness and therefore also of more vigorous growth. In line with the resolution of the EU heads of state and governments in 2010, expenditure by business, state and universities on research and development in the EU is to increase to 3% of the GDP by 2020. In Germany business is to contribute 2% and the state/universities 1% to achieve this target.<sup>1</sup>

Amongst the family businesses surveyed on average the R&D ratio (R&D expenditure/turnover) was 3.25% in 2011. This means they are exceeding the 2% mark targeted by the EU and Germany for the economy. Every fourth family business devotes as much as 4% and more of its turnover to research and development. At the same time, however, it must also be noted that a third of the family businesses surveyed do not do any R&D, amongst these many firms in the commerce and service sectors are disproportionately represented. Conversely, amongst the family businesses with R&D expenditure ratios of 2% and more, 85% are industrial companies.

**R&D expenditure ratios 2011 of major family businesses**



n = 359; Ø = 3.3%; median = 2.0%

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For this reason it is not surprising that for the commerce sector the average R&D ratio lies under 1%. Due to a few particularly research-intensive service providers, who are closely involved with their companies, the average is 3% in the service sector. Way out in front are the industry sector family businesses that had an average R&D expenditure ratio of 4.6% in 2011.

Along with the sector effect, two further effects can be ascertained. One of these observable effects is the effect size has: Hence companies with more than 1,000 employees spent on average 5% on R&D. On the other hand, the R&D ratio is higher the higher the equity ratio or the rate of return of the company is. Obviously, a good financial starting position must enable the company – independent of outside capital – to invest in R&D. At the same time, a high R&D ratio provides sustainable support for high profits and thus tends to result in a better capital base. It is not possible to ascertain conclusively how the causal chain actually works here through a one-off survey.

<sup>1</sup> see Stifterverband für die Deutsche Wissenschaft (2012), p. 4.

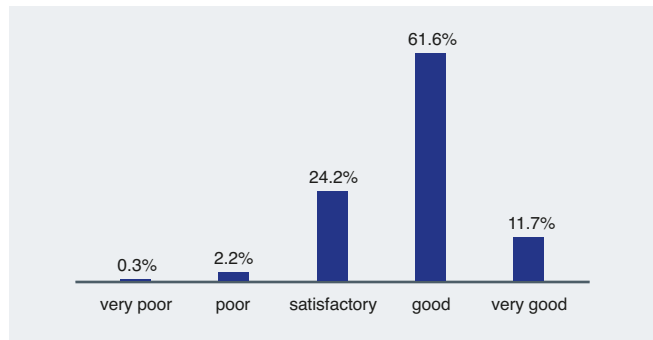


### 3. Current economic situation

#### Current economic position of the largest family businesses: good

Major family businesses have recovered very quickly and well from the financial and economic crisis.<sup>1</sup> On the basis of this observation and the economic recovery at overall business level it is not surprising that every ninth company of the largest family businesses (11.7%) estimates its economic situation as very good at the start of 2012. A further 62% of major family businesses assess their current situation as good. Only around 2% of those asked describe their economic situation as bad or very bad. On the whole the balance of the assessments, resulting from the percentage of positive reports minus the percentage of negative reports, lies at over 70 percentage points. This result is thus clearly higher than in other economic surveys such as the Ifo economic index.

#### Assessment of the present economic situation in the view of major family businesses



n = 401

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Family businesses with more than 500 employees, or with turnover of more than 100 million euros, give particularly positive evaluations of the current position. Eight out of ten family businesses with this number of employees/turnover size upwards experience their current economic situation as good or very good. Furthermore, the extent of their equity ratio correlates with the positive assessment of the economic situation. Almost 85% of family businesses with an equity ratio of more than 40% assess their situation as good or very good.

Sector-specific peculiarities, or differences resulting from the degree of globalisation, could not be ascertained. Therefore it can be assumed that, at present, all sectors are profiting from the positive situation.

#### Hardly any effects from the euro crisis on the business operations of major family businesses

In view of the measures to combat the national debt crisis, but also with regard to the continuing uncertainties within the eurozone, the question must be asked as to how or whether the assessment on the euro crisis and its direct effects on the business operations of major family businesses have changed.

In 2011 41.6% of the family businesses surveyed stated that the euro crisis was affecting their business activities negatively. For 6.8% of those surveyed negative effects were evident.<sup>2</sup> In the 2012 Spring Survey similarly many of major family businesses are assuming negative effects (42.7%). However, the percentage of those family businesses expecting serious negative effects has reduced to under 3%.

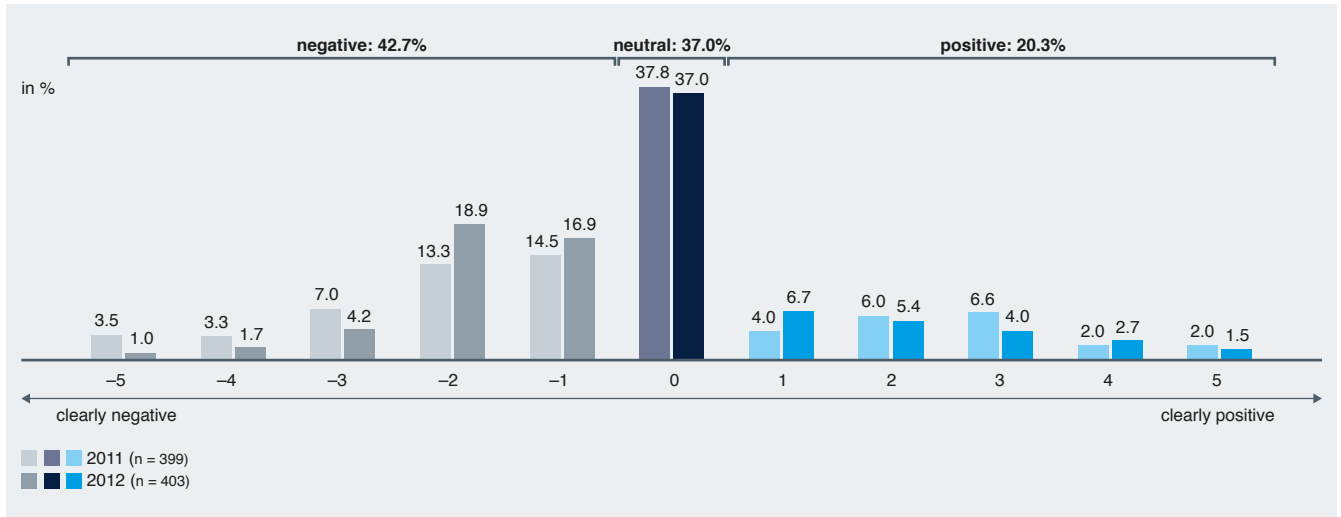
A significant reason for the sceptical or negative responses could be that some firms are anticipating a reduction in their sales figures in those euro countries hit particularly badly by the crisis. These heavily indebted euro countries have to reform their budgets sustainably, which cannot succeed without wide-ranging cuts and tax increases. Their private sectors too, above all private households, have to reduce their high levels of debt. This adjustment process will – at least in the short term – clearly dampen domestic demand. According to the EU Commission's prognosis, this will lead to a slight recession in the eurozone.

<sup>1</sup> see Lamsfuß/Wallau (2011), p. 30.

<sup>2</sup> see Boerger/Lamsfuß/Wallau, p. 23.



### Influence of the euro crisis on business operations



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In view of the continued significance of the eurozone for German exports – therefore, also for major family businesses<sup>1</sup> – it is not surprising that family businesses with an export ratio of 25% and more are anticipating negative effects from a continuation of the euro crisis.

However, approximately one fifth of the family businesses surveyed had experienced positive effects for their business as a result of the euro crisis. Here one surmises that the rather weak euro exchange rate is favouring sales of German goods in Asia and the USA in particular. The high percentage of neutral statements on the euro crisis, at 37% (37.8% in the previous year), can be explained in different ways. On the one hand, it is possible that many of the businesses do not actually feel any concrete effects or have no perception of how much the euro crisis and the financing of the rescue packages/bail outs will affect their economic situation. On the other hand, the positive and negative effects could cancel each other out in some companies. Thus the possibility exists that the euro crisis is not exerting any great influence because the countries of the European currency union are dwindling in significance for many of major family businesses whilst, at the same time, the latter are profiting from the stabilising worldwide recession.

On the whole, this means that major family businesses are only witnessing slight negative effects on their businesses. Presumably, implied in this is the hope of those surveyed that the measures taken by the politicians to stabilise the eurozone will be effective. In principle, irrespective of the business sector they belong to or their size, major family businesses are united in their vote. Family businesses into at least their third generation are the only ones anticipating a tendency towards increased negative effects on their family business.

The euro crisis thus has no major impact on the overall positive assessment of major family businesses of their own economic situation.

<sup>1</sup> The 2011 Spring Survey showed that the most significant sales markets currently for major family businesses are still in Europe, see Boerger/Lamsfuß/Wallau (2011), p. 14.

## 4. Financing instruments and forms of finance

The demands made on the creditworthiness of borrowers and on the transparency of the business processes of companies, as well as on securities provided, have risen considerably in the last few years. Companies these days are required to produce much more information about their economic situation, the company profile and the quality and realisability of their plans than in previous years. In tandem with this, a multiplicity of other finance possibilities – such as leasing, factoring or venture capital – have gained in significance for companies in the last few years. With this development in mind, the question arises as to which forms of finance major family businesses prefer these days and which ones will gain in importance in the future.

### Major family businesses prefer to finance from cash flow.

In the traditional financing culture in Germany, internal financing has been given a particularly high priority. In particular, the firms regard retained profit and write-offs as the most important basis of company finance. Major family businesses are of precisely this view. The firm's own means (cash flow) has major significance for just under half of the family businesses and a high significance for a further 40%. This means that this is by far and away the most significant finance instrument.

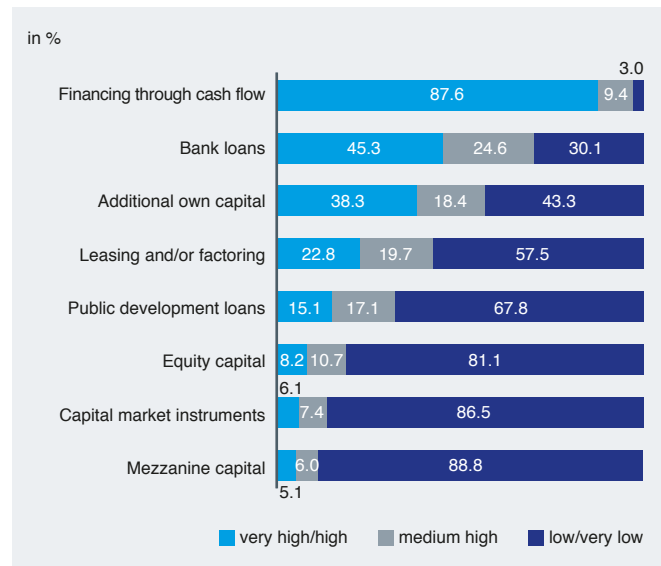
### Bank loans important mainstays in the finance structure

Despite all the changes on the market, the bank loan plays the second most important role in company finance. Now as before, nearly half of the family businesses surveyed regard bank loans as having a very high, or high, significance.

In view of the altered finance conditions and possibilities, today the firms' own equity ratios have a central significance in company finance. On the one hand, equity itself is a source of finance, on the other the level of the equity ratio as a buffer to risk influences the insolvency risk and thus creditworthiness scoring by the banks. Being endowed

with equity is also reflected somewhat in individual credit conditions. Although, according to our last analysis of the figures, the family businesses already possess on average a relatively comfortable equity ratio of 33.5%<sup>1</sup>, further improvement in equity ratio plays a significant role in the present day financing strategy of the company – 38% place high importance on this.

### Current significance of individual financing instruments for major family businesses



n = 367–402

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Bank loans do, however, remain the most important (external) mainstay for financing with the firms. This means that today as well the banks are an important source of finance for major family businesses.

Leasing/factoring represents an important financing instrument for nearly every fourth company surveyed. However, more than half of major family businesses rates the significance of leasing/factoring as low or very low for their financing.

<sup>1</sup> see Lamsfuß/Wallau (2011), p. 17ff.



Public development loans are of subordinate significance for most of major family businesses at present. One reason for this is surely the fact that the vast majority of development programmes require the EU definition of medium-sized companies to be met – fewer than 250 employees and an annual turnover of under 50 million euros. However, our definition of major family businesses (cf. chapter 1) differs substantially from the EU’s definition.

**Alternative finance instruments of minor significance**

Alternative finance forms such as capital market instruments, mezzanine and venture capital, for which growing significance is anticipated following the transition in the finance markets, only play a minor role for a large part of the family businesses at present. Now as before, the number of companies for which finance via mezzanine or venture capital comes into question – as well as the number of finance occasions for these finance tools – appear to be relatively few.

Summarising the facts in an interim upshot: Major family businesses prefer traditional finance instruments. A large portion of today’s financing is based on the two pillars, own capital and bank loans.

**Financing structure of major family businesses in future: more equity capital, more internal financing**

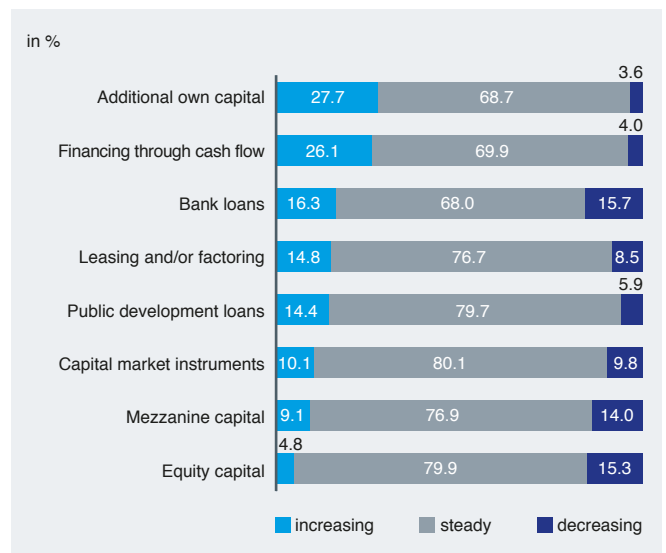
In future, additional equity capital and financing through cash flow will become increasingly important for one in every four major family businesses. This is the logical continuation of a path already entered by businesses years ago. Therefore, they have significantly increased their capital adequacy and their equity ratio in recent years. Where major family businesses had an average equity ratio of 30.1% in 2007, they have increased it to 33.5% in 2009 despite the financial and economic crisis. This trend continued in 2010 according to early evaluation results of balance sheet and profit-loss data for 2010.<sup>1</sup>

The establishment of additional equity capital was implemented mainly by leaving large portions of the profit in the business. The experience from recent years leads to the assumption that major family businesses generate additional equity capital mainly by holding on to their profits. An extension of the group of shareholders is rather unlikely, as major family businesses – as shown in chapter 4 – prefer to keep the business shares in the family on the one hand, and as the importance of venture capital will continue to decrease in future from their point of view.

The importance of bank loans, and with it the average rate of liabilities to loan institutions, is not expected to change much. In addition, for some major family businesses capital market instruments and mezzanine capital are becoming increasingly important. However, around the same number of businesses are also losing interest in these instruments.

Overall, major family businesses will continue in their efforts to finance their business with more independence by increasing their equity capital.

**Development of the importance of individual finance instruments for major family businesses**



n = 354 – 402

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<sup>1</sup> see Lamsfuß/Wallau (2011), p. 17ff.



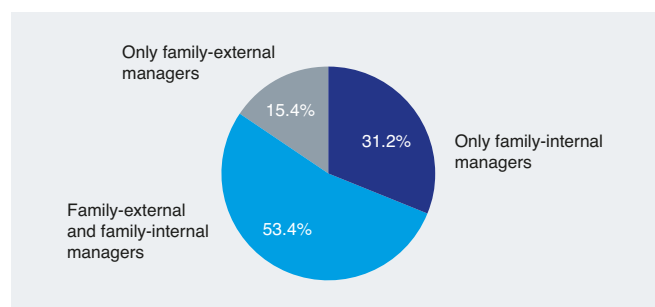
## 5. Corporate governance and company constitution

Self-monitoring and personal responsibility form an important base for successful business management. Businesses can create an independent legal regulation framework for good business management by voluntarily preparing a company constitution. With regard to these facts, major family businesses were interviewed in regard to their business management principles and the design of their company constitution.

### Family members often found in management

Around 85% of the interviewed businesses have at least one member of the owning family/families working in management. This means that a consolidation of ownership and management is not an exception but a rule in major family businesses. Nearly one third of interviewed businesses even leave the management of their business exclusively in the hands of the family. However, the percentage of family businesses being managed exclusively by members of the owning family decreases in proportion with increasing numbers of employees. Thus, only 8% of interviewed businesses with more than 1,000 employees are managed exclusively by family members. Overall, most family businesses rely on a combination of managers from inside and outside the family when it comes to their executive committee.

### Structure of management in major family businesses

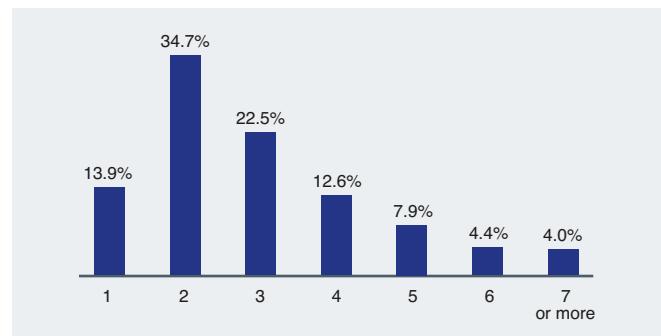


n = 404

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In major family businesses, the management board most frequently has two members. A three-member management is the second most frequent form. In addition, one in every five major family businesses has at least one woman in the management board. Overall, 7% of management members are female.

### Number of members in management board of major family businesses



n = 404

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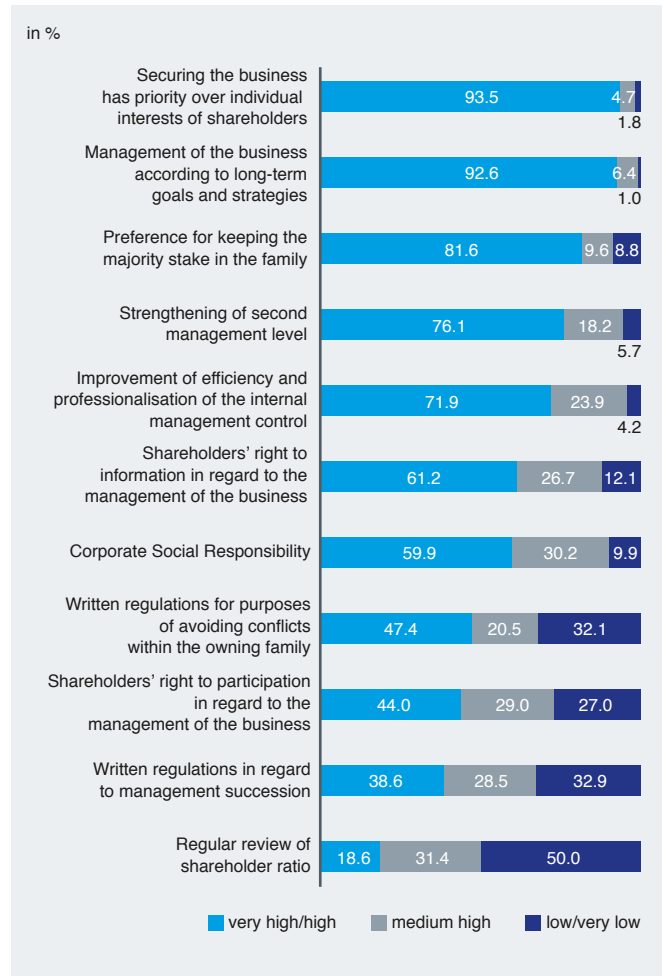


**Most important principles of management: securing the family business and focusing on long-term goals**

Two management principles are of great importance for major family businesses: On the one hand, it is important to make sure that individual interests of shareholders are inferior to the welfare of the business. Securing the survival of the business takes priority over individual interests. On the other hand, managers of major family businesses focus on long-term rather than short-term goals and adjust their strategy accordingly. This principle is especially embraced by industrial family businesses. Naturally, focusing on long-term goals is possible due to the fact that, by definition, the majority of business shares is kept in the family/families and that 85% of major family businesses actually follow the principle of consolidation of ownership and management.

Owners of family businesses want to keep their businesses in the family. Thus, eight in every ten major family businesses attach great importance to keeping the majority of shares in the family. This preference is particularly visible in businesses already in the hands of at least the second generation.

**Importance of selected aspects of business management**





### Second management level is gaining importance

Major family businesses have also realised that having a strong second management level beside a professional management board is also necessary for a successful business. Thus, three out of four businesses stated that strengthening the second management level is important or very important to them. In addition, 72% of the interviewed businesses considered the improvement of efficiency and professionalisation of the internal management control as important or very important. This is an important prerequisite for the continuous successful management of a large and growing family business that is often geared towards international markets.

More than 60% of major family businesses attach quite some or great importance to the shareholders' right to information in regard to the management of the business. Furthermore, 44% consider granting shareholders the right to participate in management of the business as important. By trend, the right to information is more important in family businesses where no family members are part of the management board. The opposite applies to the right to participate. This right is less important if the owning family/families have completely withdrawn from the management board.

### Owners of family businesses are aware of their social responsibility

Within the scope of the discussion in regard to social responsibility (corporate social responsibility) of (family) businesses, the parties involved always try to establish to what extent businesses provide for the interests of different stakeholders – such as employees or customers – outside of legal minimum requirements. Six out of ten major family businesses attach quite some or great importance to Corporate Social Responsibility, so that it may be assumed that they offer a range of opportunities, e.g. flexible working times, granting leave of absence to employees who want to take on an honorary office, environmentally friendly production, etc., within the scope of sustainable business management. So major family businesses are very aware of their social responsibility.

Close to half of major family businesses have a positive attitude towards written regulations for purposes of avoiding conflicts within the owning family/families. This issue gains importance for family businesses from the second generation and has particular significance for family businesses in their third generation, one of the reasons possibly being that, as a rule, owner structures become increasingly complex there. Written succession arrangements in the area of business management are slightly less important for major family businesses. This could be due to the fact that in many major family businesses succession is already completed or about to be completed.



**More than one third of major family businesses have a company constitution**

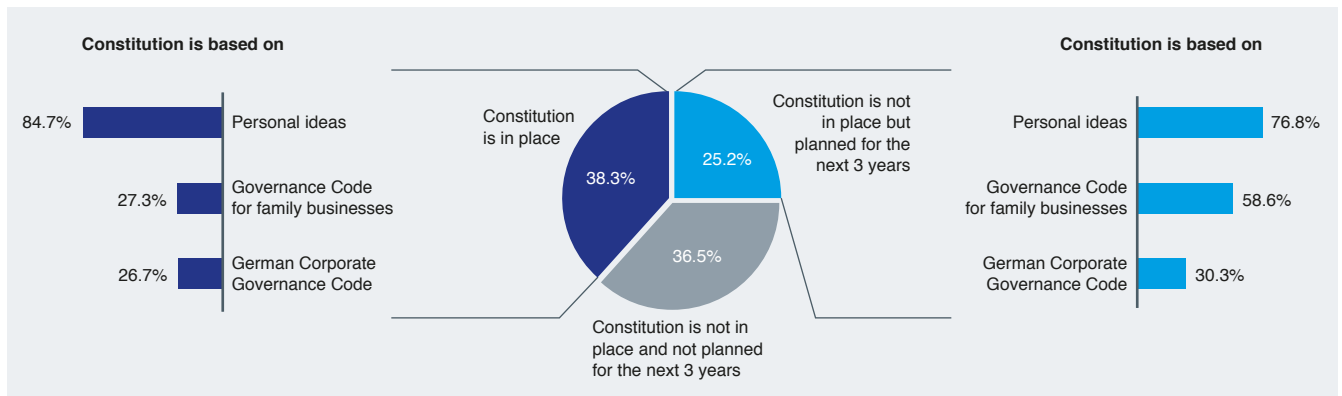
The great importance of various principles of management shows that major family businesses care about the different aspects of a corporate governance. The question is whether major family businesses have put their principles of management including, among others, the structure of decision making processes in writing by drawing up a company constitution. Writing down the corporate governance creates clear structures and prevents insecurity among employees, managers or external partners which could otherwise occur due to insufficient communication and/or lack of or inaccurate information.

Around 38% of major family businesses have set down their guidelines in a company constitution. Also, one in every four of the interviewed businesses intends to draw up such a company constitution within the next three years.

Family businesses managed exclusively by persons outside the family are more likely to, i. e. in six of ten cases, have a written company constitution. One of the reasons probably being that having a company constitution makes it easier to manage the relationship between owners and external management. Thus, as a rule, the principal-agent problem, as known from institutional economics, which often, among others, results from separating ownership and management, can be reduced.

The number of large family businesses with a supervisory board that have a company constitution is above average. This is partly due to the fact that capital-market oriented businesses are required to have a company constitution for legal reasons alone in regard to stock corporation law, as set out in the German Corporate Governance Code.<sup>1</sup>

**Putting a company constitution for major family businesses in writing**



n = 392

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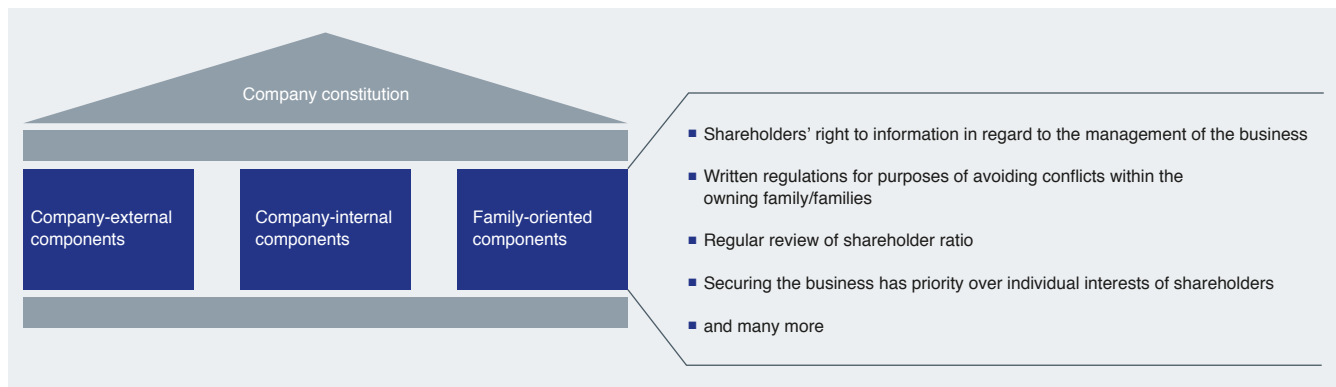
<sup>1</sup> see German Corporate Governance Code (2010), p. 1ff.



However, even non-capital-market oriented family businesses can benefit from a Corporate Governance which lays down structures in relation to decision making, influence or control processes in businesses. In addition to external and/or internal elements, the company constitution should also contain family-oriented elements – as illustrated in the following graphic illustration – providing for the special characteristics of family businesses. That way, regulations in regard to the right to information and the right to participation can help avoiding conflicts between family members.<sup>1</sup> The so-called Governance Code for family businesses, which offers a non-binding framework, can be used as a guideline when putting the constitution in writing.<sup>2</sup>

However, it should be noted that today, as in future, the majority of family businesses rely mainly on their own expectations when putting their company constitution in writing. This is not surprising, as the illustrated topics, e.g. the regulation of ownership and management structures, are to be dealt with individually in each family business by way of a company constitution.

#### Components of a company constitution in family businesses



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<sup>1</sup> see Koeberle-Schmid, Fahrion, Witt (2010), p. 26.

<sup>2</sup> see Governance Code for family businesses (2010), p. 1ff.



## 6. Advisory boards in major family businesses

### Advisory boards are set up in one third of all major family businesses

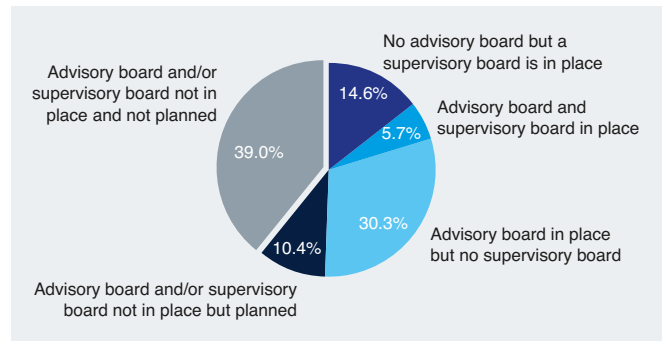
Some major family businesses are required by law to implement a supervisory committee. Overall, one in every five interviewed businesses have a supervisory board. This includes especially<sup>1</sup> family businesses operating as public limited companies.

Alternatively, or in addition to setting up a supervisory board due to legal requirements, businesses can create a voluntary advisory board. There are no legal recommendations in regard to its structure which allows businesses to form the committee according to their individual requirements. This includes especially the individuals in such committees, their responsibilities and the frequency of board meetings.<sup>2</sup>

Overall, 36% of major family businesses currently have an existing advisory board to assist them in their business operation. Depending on industrial sector, research shows that nearly every second industrial family business has an advisory board. In contrast, only every fourth trading business and/or every fifth service-providing company has an advisory board.

Whether a family business has an advisory board or not also positively correlates with the size of the business. Of all interviewed family businesses with less than 250 employees only one in six has an advisory board; among family businesses with more than 1,000 employees, every second business has an advisory board (54.2%).

### Advisory boards in major family businesses



n = 403

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It is striking that especially older family businesses resort to the services of an advisory board. Among major family businesses which are still owned by the first generation of owners, only one in six (17.6%) has an advisory board; this percentage increases to as much as 27% among family businesses owned by the second generation of owners. When it comes to families in the hands of the fourth or even later generation of owners, every second one has an advisory board. This observation could be explained by the fact that it is those family businesses which have no family members left in the management that have an advisory board in place. This is why an advisory board can be found in 59% of those businesses.

In addition, one in every ten family businesses, especially the younger and smaller family businesses, intend to have an advisory board in place within the next three years. Overall, six of every ten major family businesses will then have a supervisory and/or an advisory board.

<sup>1</sup> There are also some family businesses with the legal status of the GmbH (limited liability company) which have a supervisory board due to provisions in their company contract or due to legal regulations on co-determination.

<sup>2</sup> see Heilgenthal/Hübner/Thömmes (2012), p. 19ff.

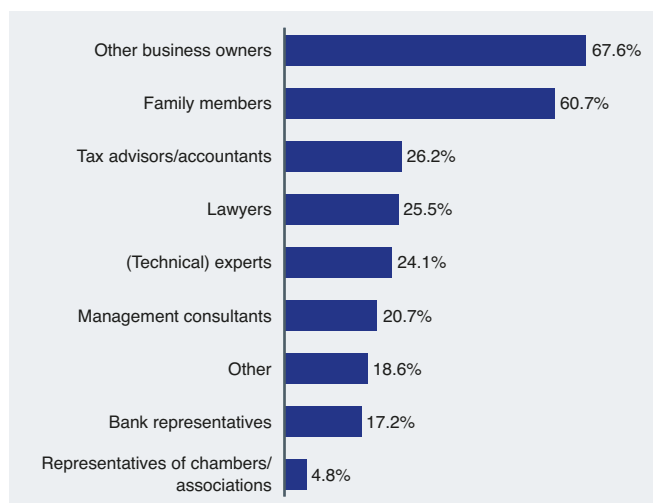


### Strong presence of owning family/families also in advisory boards

The advisory board gives the owning family/families the opportunity to exert influence on the management. Therefore, in around 60% of major family businesses, at least one member of the family is represented in the advisory board. The probability of at least one family member being appointed to the advisory board especially increases where no member of the family is part of the management. While in family-run businesses only 57% have at least one active member of the family in the advisory board, this percentage increases to 72% in non-family-run family businesses.

Furthermore, major family businesses use the advisory board to bring valuable external specialist know-how into the business. The most favoured and frequent choice in this respect is the advice of other (friendly) businesses owners. Other entrepreneurs can be found in two of three advisory boards. In addition, every fourth advisory board calls on the know-how of tax advisers/accountants, solicitors, management consultants and/or technical specialists. Representatives of banks and chambers are only represented in around one in six or twenty advisory boards respectively.

### Structure of advisory boards in major family businesses



n = 145; multiple appointments: 385 replies

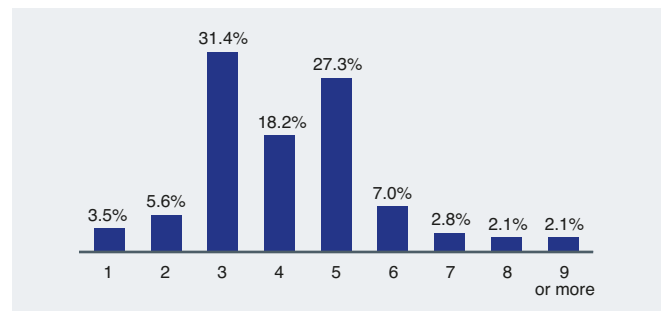
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### Advisory board members: quality over quantity

In addition to the member-related structure of the advisory board, the number of members of advisory boards can also be designed individually. For theoretical reasons, the number of advisory board members should be odd, where possible, to avoid any impasse in voting. In practice, around two thirds of the interviewed family businesses decided to have an odd number of advisory board members. The most frequent occurrence are advisory boards with three (31.4%) or five (27.3%) members. These are followed by advisory boards with four members (18.2%). This means that more than three quarters of advisory boards in major family businesses have only three to five members.

Overall, 12% of advisory board members are female. Thus, one of three advisory boards in family businesses have at least one woman; every tenth advisory board even has two women. The probability of women, in most cases, family members, being found among advisory board members increases where family members are represented in the advisory board.

### Number of members in advisory boards in major family businesses

n = 143;  $\bar{x}$  = 4.2; median = 4.0

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The number of members in advisory boards strongly depends on whether or not any members of the owning family/families are represented in the advisory board themselves. If there are no family members in the advisory board, the board is usually smaller with an average of 1.6 members. Advisory boards with at least one family member, on the other hand, consist of an average of 2.3 members.

The number of advisory board members also increases in parallel with the size of the business. However, the number of advisory board members is kept reasonably small. Even advisory boards in businesses with over 1,000 employees are made up of an average of five members.

Overall, major family businesses attach more importance to competence than to mass when it comes to choosing their advisory board members.

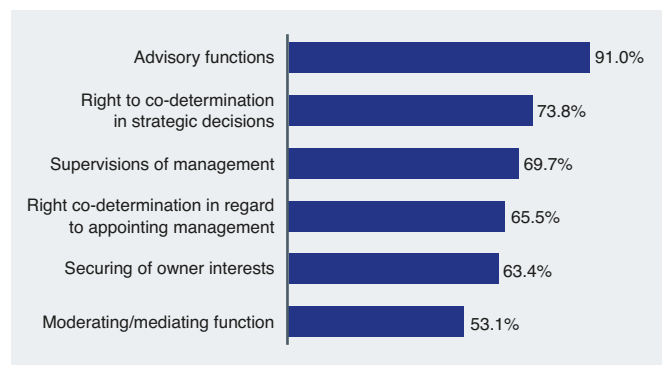
**Advisory boards are often in charge of tasks similar to those of supervisory boards**

Generally, a family business can decide individually what tasks are assigned to the advisory board. Thus, the responsibilities of an advisory board can be adjusted to suit the situation of the respective family business and designed individually, i. e., the tasks range from purely advisory activities to competences similar to those of a supervisory board.

The important key competence of an advisory board is certainly to advise and assist the management. It is therefore not surprising that nine out of ten major family businesses indicated that their advisory board is in charge of this task. In around 11% of the cases, this is also the only function of the advisory board.

In addition, family businesses have assigned other responsibilities to their advisory boards. With that in mind, the second most frequently indicated responsibility of the advisory board is assisting the management with strategic decisions. Furthermore, around 70% of the interviewed businesses said that the advisory board is responsible for supervising the management. Close to two thirds of the family businesses also give the advisory board a say in appointing staff to management positions (65.5%). Six in ten advisory boards are in charge of securing the interests of the owners (63.4%).

**Responsibilities of advisory boards in major family businesses**



n = 145

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The tasks of “securing the interests of the owners” and “supervising the management” strongly depend on whether any family members are still represented in the management. If the management is made up exclusively of non-family members, there is a requirement for supervision within the meaning of the principal-agent theory. In this constellation, it is within the scope of the advisory board’s responsibilities in nine out of ten cases to make sure that the management acts in the interest of the owners.

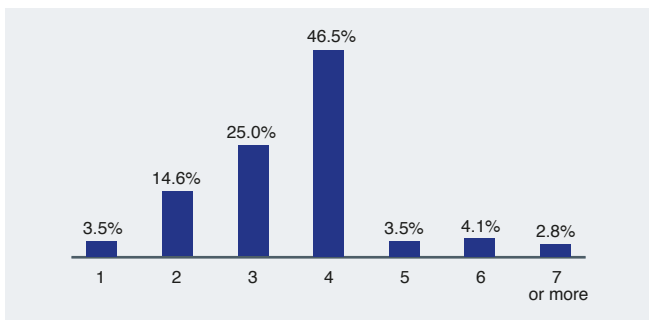
By trend, older and larger family businesses also assign more tasks to their advisory boards. In addition, the number of members in an advisory board increases in parallel with the number of tasks assigned to it.



### Most advisory boards hold two to four meetings every year

The advisory board members meet several times a year in order to take care of the responsibilities assigned to them. At around 86%, most advisory boards hold on average two to four meetings every year. Around half of the advisory boards hold one meeting per quarter. Other practices, such as monthly, half-yearly or yearly meetings, are rather unusual for advisory boards in major family businesses.

#### Average number of meetings per year



n = 144;  $\bar{x}$  = 3.8; median = 4.0

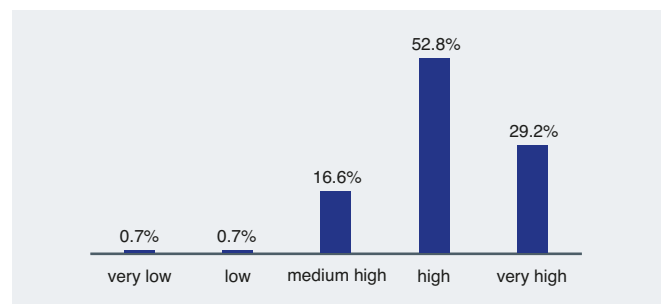
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### Family businesses are highly satisfied with their advisory boards

Most major family businesses have a very positive opinion about their advisory boards. Around 30% of the interviewed business owners are very happy with the way their advisory board takes care of its tasks. More than half of the interviewed businesses are quite happy with their advisory board. Only very few businesses expressed a negative opinion.

By trend, older and larger family businesses have a better opinion of their advisory board than younger ones. This could be due to the fact that more and more of the older family businesses are managed by external staff, which means that these family businesses benefit more from the functions assumed by the advisory board.

#### Satisfaction with advisory boards in major family businesses



n = 144

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Based on the results, it can be assumed that the services of an advisory board which can be designed to suit the needs of the business is clearly valued by major family businesses. In addition to that, many family businesses consider the advisory board as an important instrument in the organisation of their business management.





## 7. Company succession

A successful transfer of the business can determine whether ownership and/or management stay in the family, the business continues to follow its strategic goals and whether it can continue to be competitive on the international market. These existential aspects are not just very important for the family businesses involved, but also for their staff, customers, suppliers, investors and other stakeholders involved with the business. An interesting finding in this regard is that the majority of the businesses agree when it comes to goals and problems of the change of generations – independent of the size and age of the business, sector and level of internationalisation. This can be seen as proof of the specific business philosophy of family-run businesses.

### More than half of the major family businesses are in the hands of the third or even later generation

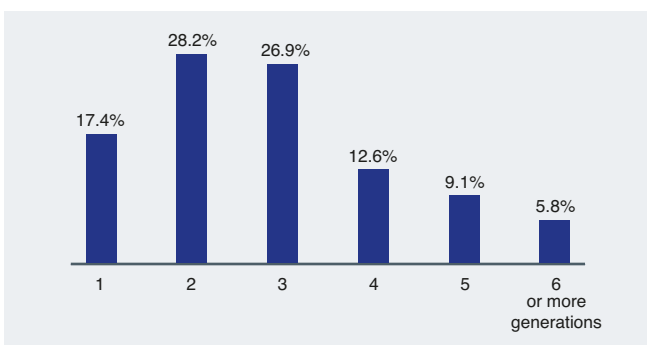
Most of the major family businesses are currently in the hands of the second or third owner generation. Therefore, the change of generations is not an unknown territory for more than 80% of major family businesses. They dealt with it successfully once or several times before.

Service-providing companies tend to be younger on average and are often in the hands of the second owner generation; industrial businesses are on average run by the third owner generation. One notable aspect is that some family businesses have managed to advance to the “major family businesses” category as early as during their foundation stage in the hands of the founder generation. The other aspect is that a strong quarter of major family businesses are very traditional and currently run by the fourth or even later generation.

### Important objective: to keep 100% of the family business in the hands of the family

Keeping the family business in the hands of the family is an important objective for business owners. On average, 97% of business shares are currently in the hands of the family estate. In detail, this means that with 85% of the interviewed owners, the business is completely in the hands of the family, with 10% of the cases, the family owns at least 75% of the business. At 85%, the percentage of non-family members in these businesses is significantly higher. This fact indicates that, among other ways, external managers are tied to the business through small business shares.

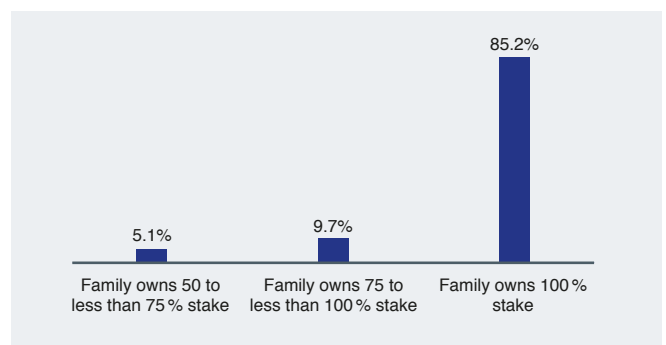
Major family businesses in the hands of the generation ...



n = 397

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Ownership structure in major family businesses

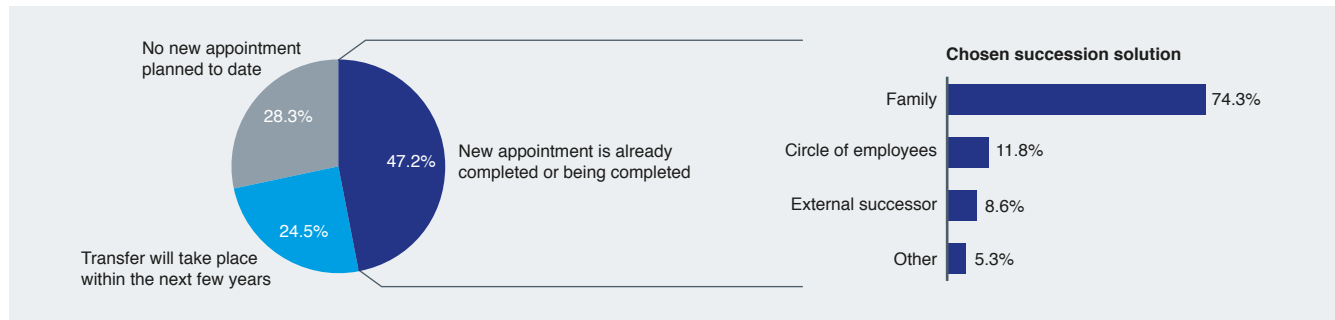


n = 391

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### Current situation surrounding the change of generations in major family businesses



n = 403

n = 187

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The issue of succession arises when the owner retires from the management of the business for health or age reasons or when the owner dies. Close to half of the family businesses interviewed as part of the latest survey had to face new appointments and/or a transfer in recent years or are currently facing it. Around one quarter of the family businesses are about to face a change of generations in the near future – most of them within the next five years. The last quarter of major family businesses have no concrete plans in relation to the process of appointing a succeeding management board.

Taking into consideration all major family businesses, around 2,100 family businesses have already dealt with a change of generations. The other family businesses are about to face a transfer of management to the next generation in the near future.

### Clear preference of family-own management succession

Close to three quarters of the interviewed family businesses which have already completed a change of generations in recent years or are currently in the process of doing so chose successors from their own family. In deviation from overall economic data in regard to succession to the business, according to which only half of family businesses are transferred within the family, succeeding generations among major family businesses show a higher-than-average willingness to take over the family business. The remaining quarter chose a successor from outside the family. In these cases, the successor is often chosen from the internal circle of employees (management buy-out), followed by the implementation of an external successor (management buy-in). Only a very small number of businesses were sold to a different business or a trust was established.

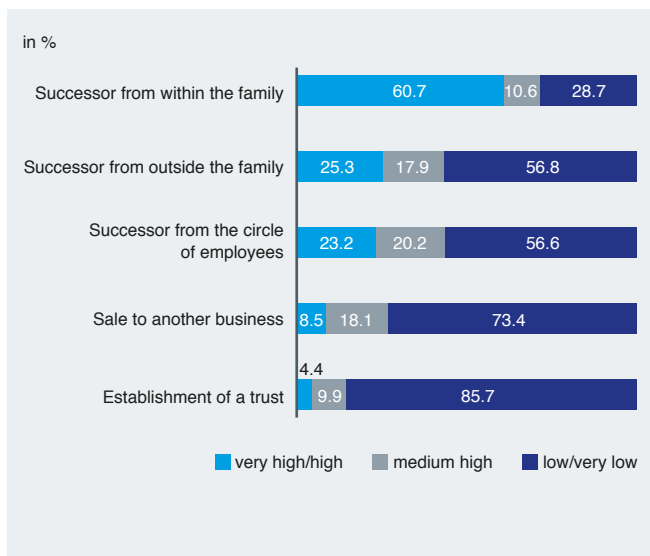


Of all major family businesses which face a change of generations within the next few years, the majority also prefers a family-internal solution. Around 61% of these family businesses are likely or very likely to choose a successor from within the family. At least around 25% consider a successor from outside the family as a (very) likely solution. Around 23% of businesses facing a change of management would not rule out the possibility of finding a successor among their own staff either. The sale of the business to another business and/or the establishment of a trust on the other hand is considered as very unlikely by the majority of businesses.

**Finding a suitable successor – the most important aspect in relation to succession to a business**

For most business owners, transferring the business to the next generation is associated with two aims. On the one hand, they want to preserve their life’s work for future generations; on the other hand, they want to fulfil their obligations towards the family and the business. This is why the succession process must be prepared carefully and planned in the long term while taking into consideration a series of aspects. From the point of view of the sample businesses, the most important key (to success) is finding a suitable successor.

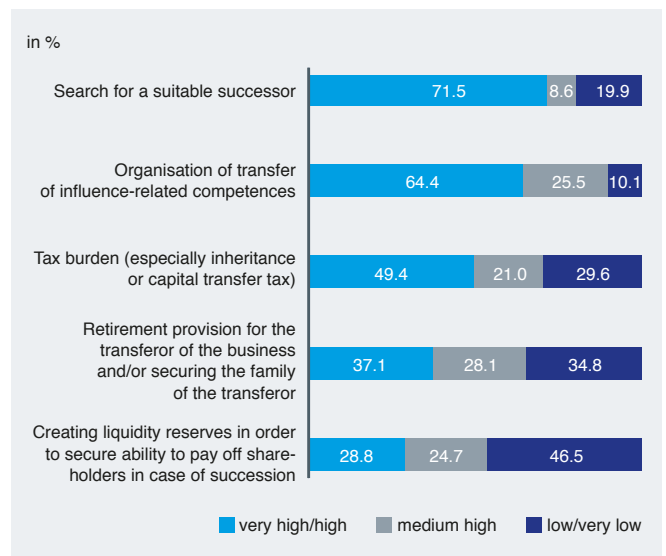
**Probability of succession solutions in major family businesses**



n = 91–99

© IfM Bonn

**Importance of key aspects in relation to succession to a business**



n = 267

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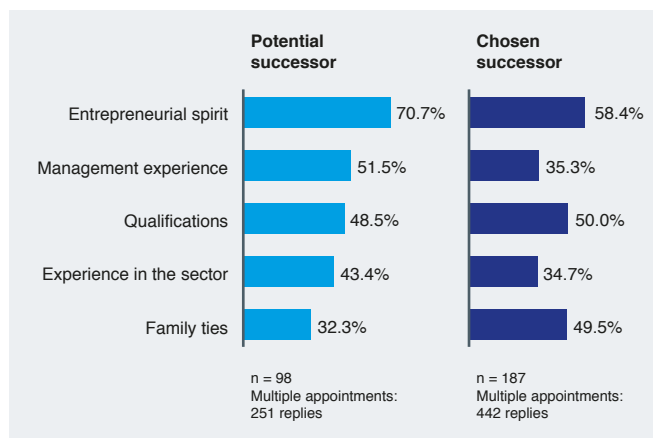


### Suitable successors must have entrepreneurial spirit

Major family businesses know exactly what properties and skills they expect from the successor. A suitable successor should especially show entrepreneurial spirit; most major family businesses consider this as the most important property. Furthermore, they would like their successor to have professional qualifications and several years of experience in the job and the sector.

However, differences could be found between this desired profile and the actually realised (actual) profile. Entrepreneurial spirit was indicated as the most important property by major family businesses which have successfully implemented succession in recent years. But the aspects of professional and sector-related experience lost importance, given that the successor can and/or should learn those skills in a short period of time. Family ties on the other hand significantly gained importance. This clearly proves that in the end, the goal of keeping the business in the family is even more important than owners of family businesses initially believe. Therefore, the ideal successor comes from within the family, is highly qualified and shows entrepreneurial spirit.

### Characteristics of potential and/or already appointed successors



In addition to choosing the right successor, the transferor also attaches great importance to the realisation of concrete transfer rules, such as regulation of influence and competence between transferor and transferee (64%). This is very important, considering that during the process of changing management a mutual transition period is often agreed, which on the one hand allows the transferor to share his knowledge with the next generation and on the other hand gives the successor the opportunity to familiarise himself with the business.

Nearly half of the major family businesses attach great importance to the aspect of tax burden in connection with succession to the business. Obviously, the amendment to the inheritance and capital transfer act 2009 has not led to major family businesses attaching less importance to tax matters during the process of changing management, despite the new version providing for basic relief for business assets.

More than one third of the major family businesses also consider the settlement of the retirement pension of the transferor and their family as an important aspect. The only aspect the businesses do not seem to be as concerned about is creating liquidity reserves in order to secure their ability to pay off shareholders in case of succession. This could be due to the fact that most family businesses are wholly owned by the family and therefore do not have to deal with this topic too often.



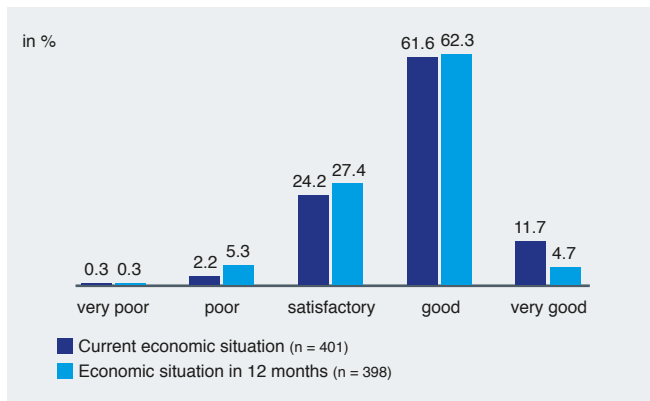
## 8. Outlook 2012

### Major family businesses expect the economic situation to be good, even in twelve months

Generally, major family businesses see their own economic situation for the next twelve months in a positive light. Nearly two thirds of all interviewed businesses expect their economic situation to be good and/or very good in twelve months.

In comparison with the assessment of the current economic situation, a slight deterioration tends to transpire. Thus, the percentage of family businesses which expect their economic situation to be very good in twelve months is declining. At the same time, the percentage of those expecting their future economic situation to be bad is rising. Despite of all that, the assessment balance (positive assessments less negative assessments) still comes to over 60 percentage points, meaning that overall, major family businesses rate their business situation in twelve months at an average of “B minus“ (expressed in school grades).

#### Assessment of the current and the future economic situation from the point of view of major family businesses



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In regard to the future forecasts, all major family businesses agree, independent of their sector, their size or their export orientation. Only family businesses which are run by the third or later generation see their future economic situation in a more pessimistic light; these expectations are based on the expected negative impact of the sovereign debt crisis (see chapter 3).

In light of the continuing business cycle risks (European and sovereign debt crisis, weak economic cycle in the US and the slow-down of economic growth in Asia), it was surprising at first to see that the negative impact on the assessment of the future economic situation was only slight. However, considering the forecasts for the development in profit, employee and investment matters, this optimism is indeed justifiable.

Thus, nearly two thirds of family businesses expect to be able to increase their profits in 2012. Only 7% of them expect a fall in profits. Although foreign markets are becoming increasingly tough, two thirds of the businesses expect to be able to keep their export quota at the same level, while around one third of the sample actually expect an increase in their export quota. Depending on the sector, the results showed that four in ten large industrial family businesses expect a higher export quota.

### Major family businesses will continue to send out important incentives for the German employment market in 2012

These positive sales forecasts continue to encourage major family businesses to create new jobs. Major family businesses already impressed by sending out positive employment signals in the past. That way, major family businesses were able to stimulate a growth in employment of 7.8% and/or 2.5% p. a.<sup>1</sup> between 2007 and 2010.

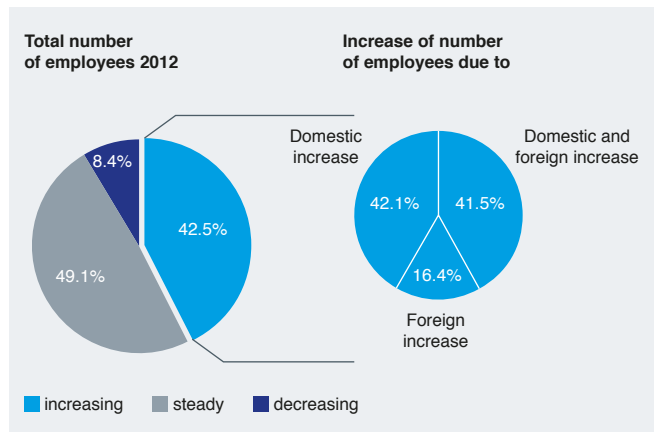
<sup>1</sup> see Lamsfuß/Wallau (2011), p. 30.



Four in ten major family businesses intend to increase their number of employees in 2012. The new jobs will be created mainly in Germany. With regard to this, there are clearly more businesses which intend to increase their number of employees in the country than the other way round. Even the largest, in most cases industrial, family businesses which are active abroad intend to create jobs in Germany and abroad.

This increase in investment-related spending is particularly beneficial for Germany as a location. Thus, a large percentage of businesses increasing their total investment-related budget intend to implement this vision by investing in Germany. It is also notable that even the large family businesses operating abroad will increase their investment budget in Germany rather than abroad.

#### Expected development of employee numbers for 2012

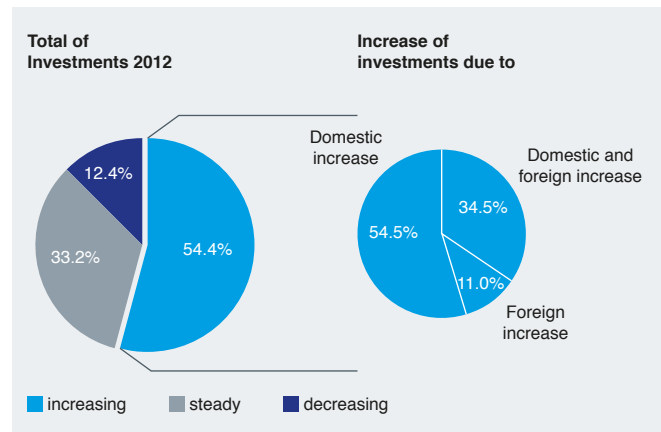


n = 405

n = 171

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#### Expected development of investments for 2012



n = 404

n = 209

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#### Incentives for demand for investment goods just as positive

However, major family businesses are also aware of the fact that they will need to invest in the future if they want to be competitive and successful in years to come.

This transpires in the fact that more than half of the major family businesses intend to increase their investment-related spending in 2012. A closer look at the businesses according to industrial sectors reveals that especially family businesses plan to expand their investment budget (57.9%).

In addition to this, seven in ten major family businesses plan to keep their, in some cases, large R&D budgets at the same level in 2012; one in four businesses even plan to increase it in 2012. This includes especially large industrial family businesses and those with a powerful export branch.

Overall, the high percentage of major family businesses wanting to increase their investment budgets in Germany reflects the appeal of Germany as a location. It is a strong commitment of major family businesses to Germany as a location.



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This study presents the results of the 2012 Spring Survey of major family businesses with an annual turnover of more than 50 million euros. The main emphasis of the survey is on the current and future economic situation and the principles guiding their management of the company. The financing structure, the activity of the advisory boards and company succession were also examined.