

# Private Equity and Generational Change

## The Contribution of Private Equity to the Succession of Family Businesses in Europe

# Research Paper

Research Paper



An EVCA Buyout Committee Paper  
March 2005

This paper is based on a pan-European survey conducted on behalf of EVCA by the Centre for Management Buy-out Research (CMBOR), Nottingham University Business School. With special contribution from Professor Fabio Buttignon et al., University of Padua.



European Private Equity &  
Venture Capital  
Association



## **About EVCA**

The European Private Equity and Venture Capital Association (EVCA) was established in 1983 and is based in Brussels. EVCA represents the European private equity sector and promotes the asset class both within Europe and throughout the world.

With over 950 members in Europe, EVCA's role includes representing the interests of the industry to regulators and standard setters, developing professional standards, providing industry research, professional development and forums facilitating interaction between its members and key industry participants including institutional investors, entrepreneurs, policy makers and academics.

EVCA's activities cover the whole range of private equity: venture capital (from seed and start-up to development capital), buyouts and buyins.

## **Disclaimer**

The information contained within this report has been produced with reference to the contributions of a survey conducted on behalf of EVCA by the Centre for Management Buy-out Research, Nottingham University Business School. Professor Fabio Buttignon et al of the University of Padua have provided additional information. EVCA has taken suitable steps to ensure the reliability of the information presented; however, it cannot guarantee the ultimate accuracy of the information collected. Therefore neither EVCA, the Centre for Management Buy-out Research (CMBOR), Nottingham University Business School nor Professor Fabio Buttignon et al., University of Padua, can accept responsibility for any decision made or action taken, based upon this report or the information provided herein.

# Contents

<b>Foreword</b>	2
<b>Executive Summary</b>	3
<b>Excuse: Buyouts of Family Businesses in Italy</b>	8
<b>1 Background Characteristics of the surveyed Businesses</b>	7
1.1 Most family businesses were owned by a single family	7
1.2 The founders still owned 71% of the companies at the time of the buyout	8
1.3 75% of shares held by the family owners prior to the buyout	8
1.4 Survey participants operate over a broad range of industry sectors	9
<b>2 Succession Planning</b>	10
2.1 Lack of a successor is the principal reason to sell	10
2.2 Over 20% of family businesses do not formally plan succession	10
2.3 Majority preferred selling to private equity funds	11
2.4 Management co-planned succession in 63% of cases	12
2.5 In well over half the cases private equity funds contributed to succession planning	12
<b>3 The Buyout Process</b>	13
3.1 In almost a third of the cases the vendor approached an independent consultant or advisor	13
3.2 Long-term faith in the company is the main motivation for managers to undertake a buyout	13
3.3 Private equity funds structured the finance and evaluated potential market growth	14
3.4 The management and the vendor mutually agreed on the price in more than half of the cases	15
3.5 Management and vendor shared underlying information equally in close to 43% of the cases	16
3.6 Need for active and faster commitment from participants, but less outside advisors and lawyers	16
<b>4 After the Buyout</b>	18
4.1 Private equity firms take an average 45% stake and management close to 37%	18
4.2 A typical buyout management team consist of four managers	18
4.3 Family members give up on their executive positions in favour of managerial positions	19
<b>5 Corporate and Business Strategy of the Buyout</b>	20
5.1 Companies become more cash flow oriented after the buyout	20
5.2 Flat management styles and improved communication after the buyout	20
<b>6 Performance of the Company</b>	22
6.1 Employment increases on average by 67.3% to 440 employees	22
6.2 Turnover grew annually by 15.4% and PBIT by 11.3% after the buyout	23
6.3 Export activities increase from 23.9% to 28.4% of sales	25
6.4 One third of the companies surveyed state that without private equity they could not have continued as an independent entity	25
<b>7 Relationships with Private Equity Funds</b>	26
<b>8 Conclusion</b>	28
<b>Appendices</b>	29
Appendix 1: Survey Methodology	29
Appendix 2: Analysis of Responses by Business Sector	31
Appendix 3: Definitions	33

# Foreword

Family businesses are the backbone of the European economy, accounting for over 70% of jobs<sup>1</sup> and contributing to between 55-65% of the GNP of European Union (EU) member countries<sup>2</sup>. Many of these businesses face a change of ownership, largely due to the retirement of the generation running the firm. The issue of 'succession', whether transferring company assets from one generation to another or selling to a third party, poses significant problems for the future growth of the European economy. The European Commission's Expert Group on the Transfer of Enterprises estimated that 610,000 businesses a year, accounting for 2.4 million jobs, could change hands in this decade. In addition, it calculated that up to 1.5 million enterprises could close because of the lack of obvious successors in the next ten years, with the consequent loss of 6 million jobs<sup>3</sup>.

Against the background of the Lisbon process within the EU<sup>4</sup>, encouraging both the growth as well as the preservation of these businesses is vital not only for the success of the Lisbon process but also for long-term economic prosperity and the sustainability of jobs and livelihoods in Europe.

The European private equity industry can provide a solution for family businesses facing succession issues by actively investing in and supporting the growth of these businesses, through the managed process of a buyout or buyin<sup>5</sup>. In 2003, some 60% of the total private equity investments in Europe were invested to re-energise and revitalise existing, often family-owned, companies.

A buyout is strictly defined as a transaction in which the management acquires a business or company from the current shareholders with the support of private equity investors. However, these investors can also provide long-term value to a company through the implementation of a more clearly defined business strategy, with sharper and more focused operational and financial controls. This often enables private equity backed companies to attain their next level of development and growth.

This study by CMBOR on behalf of EVCA is designed to reveal some important insights into the planning of succession by family-owned businesses as well as highlight the role that private equity can play in the family buyout process – both financial and non financial.

EVCA strongly believes that this study will help family businesses and their management to gain better insight in the benefits of a private equity led buyout. The findings clarify the processes involved in a buyout and confirm it as a viable alternative for solving succession issues. Furthermore, EVCA calls on governments to review legislation in order to favour buyouts of family businesses.

Jonathan Russell  
Chairman EVCA Buyout Committee  
3i Group

<sup>1</sup> European Group of Owner Managed and Family Enterprises, 'Family Businesses in an Enterprise Economy', November 2003.

<sup>2</sup> 'Family Businesses Dominate', International Family Enterprise Research Academy, 2003.

<sup>3</sup> European Commission, 'Transfer of businesses – Continuity Through a New Beginning', Final report of the MAP 2002 project, August 2003.

<sup>4</sup> The commitment by EU leaders at the Lisbon Spring EU Council in 2000 to make Europe the world's most advanced innovative and competitive knowledge-based economy by 2010

<sup>5</sup> For the purpose of this study, the term buyout will include buyouts, buyins, management buyouts, management buyins, buyin-management-buyouts, institutional buyouts and leveraged buyouts. See also definitions at the end of the paper for explanations.

# Executive Summary

Buyouts in general, and management buyouts and management buyins in particular, have become a significant component of the European private equity and venture capital market, which has seen considerable growth in value over the last two decades. Buyout investments have grown in importance within the market, rising in value from €2.38 billion in 1994, (44.1% of the €5.4 billion total private equity investment), to €18.42 billion in 2003 (63.3% of the €29.1 billion total)<sup>6</sup>. A significant proportion of buyouts involve the acquisition of family owned companies. According to CMBOR, up to one quarter of all European buyouts come from family/private sources. At the same time, a significant number of European family businesses face generational change at owner level, often without having a suitable successor available to take over the business. This makes family businesses a significant source of deals for the European private equity industry.

However, in general the role of private equity in buyouts of family businesses often seems to be misunderstood. This study aims to inform the reader about aspects of succession planning and about the sale process of family-owned businesses to private equity funds. Moreover, strategic issues, management styles and the performance of the business before and after the buyout are examined. Finally, a closer look is given to the relationship between the portfolio company, i.e. the acquired business, and the private equity fund.

To examine these issues, 1,645 European former family businesses, which were subject to a private equity backed buyout between 1994 and 2003, were contacted using a postal survey. A total of 117 completed questionnaires were returned, representing an overall response rate of 7.1%. The sample was cross-checked for representativeness with respect to year of buyout, location and business sectors (see Appendix). For the performance analysis, additional financial information from publicly available sources was analysed.

## Key findings

### Contribution of private equity funds to the family businesses

- The main non-financial contributions of private equity funds are to act as a sounding board for management ideas, be a key source of contacts, and assist with the recruitment and development of management.
- The key financial and operational contributions of private equity funds are monitoring financial and operating performance as well as regular budget reporting.
- Moreover, private equity funds played an important role in managing the relationship between the family owners and the portfolio company management.

### Post buyout performance

- The average number of employees rose from 263 before the buyout to 440 employees afterwards.
- The post buyout compound annual growth rate in turnover was between 13.3% for the reference data and 15.4% for the survey data.
- The post buyout compound annual growth rate of profit before interest and taxation (PBIT) was between 10.3% for the reference data and 11.3% for the survey data.
- Thirty-three percent of the respondents said that without private equity their company could not have continued as an independent entity.

<sup>6</sup> Source: Annual Surveys of Pan-European Private Equity & Venture Capital Activity, conducted on behalf of EVCA by Thomson Venture Economics and PricewaterhouseCoopers.

# Executive Summary

## Succession

- The principle reason given for the sale of the business was a lack of a suitable successor.
- Few companies had planned succession more than one year in advance and almost a quarter of companies had not undergone any formal succession planning at all.
- In nearly two thirds of the cases management has been involved in succession planning while in over half of the cases private equity funds were involved.

## Background characteristics of the surveyed businesses

Prior to the transfer of ownership, the shareholders of the surveyed companies were either a single family related by blood or marriage owning over 50% of the voting shares (76.9% of the responses) or shareholders from more than one family (23.1%).

In 70.9% of cases the founders still owned the family business at the time of sale, while the remainder of cases either inherited or bought the firm.

## Succession planning

The main reason for the sale of family businesses, according to the respondents, was the lack of a successor. Despite this, only 33% of companies undertook formal succession planning more than a year in advance. In 21.7% of the cases, no formal succession planning had taken place before the buyout.

In 63% of cases, the management was involved in succession planning and in 58% of cases the private equity funds were involved as well.

## The buyout process

In 28.1% of transactions, the vendor approached an independent consultant to help sell the business.

The main motivation for managers to undertake the buyout was their long-term faith in the company followed by a desire to control their own business.

During the buyout process, private equity funds contributed mainly by structuring the finance, followed by assistance with the due diligence process. The key support to the companies' operations was evaluating potential market growth followed by reviewing the existing and suggesting new management.

More than half of the respondents reported that a mutually agreed price was negotiated. However, only 42.6% of respondents indicated that vendor and management shared relevant information equally, whereas in a similar number of cases, the vendor controlled all or most of the relevant information.

## Post buyout management

Buyout teams generally consisted of four members, with an average of one person leaving the team and two joining following the sale. On average, one representative from the investing private equity fund acted as a non-executive director per company.

## Corporate and business strategy

Before the buyout the three key strategic issues were net profit, cash flow and sales growth. These were followed by long-term profitability, market value increment and return on shareholder equity. At the time of the survey, the same answers were given, but in a different order, with cash flow improvement, net profit and long-term profitability coming up on top of the list.

Before the buyout there was a strong emphasis on decision making by the CEO or the senior managers and channels of communication were perceived as unstructured. After the buyout the situation changed and the management became more adaptive to changing circumstances with less concern for past experience. Moreover, access to important financial and operating information was more openly available throughout the business.

## Performance of the businesses

The average number of employees before the buyout was 263, rising to 440 employees afterwards. The greatest growth was observed in companies with 50 or fewer employees (388%). This was followed by the growth observed for companies with over 500 employees (151%).

The average turnover increased yearly and the post buyout compound annual growth rate was 15.4%. The post buyout compound annual growth rate of PBIT was 11.3%. The results for a sample of 224 buyouts of family businesses published by Dun&Bradstreet, OneSource and Zephyr support the findings of this study. There, the post-buyout compound annual growth rate of turnover, was 13.3% and 10.3% for PBIT.

Respondents indicated that without private equity investment the company could not have continued as an independent entity in 32.7% of cases.

## Relationship with private equity funds

The three main areas of financial and operational contribution from the private equity fund are considered to be the monitoring of the financial and operating performance as well as regular budget reporting.

The three key non-financial contributions were acting as a sounding board for management ideas, identification of contacts and the recruitment and development of the management.

Sabine Rummel  
*EVCA Research Coordinator*  
Email: [sabine.rummel@evca.com](mailto:sabine.rummel@evca.com)



# Excuse

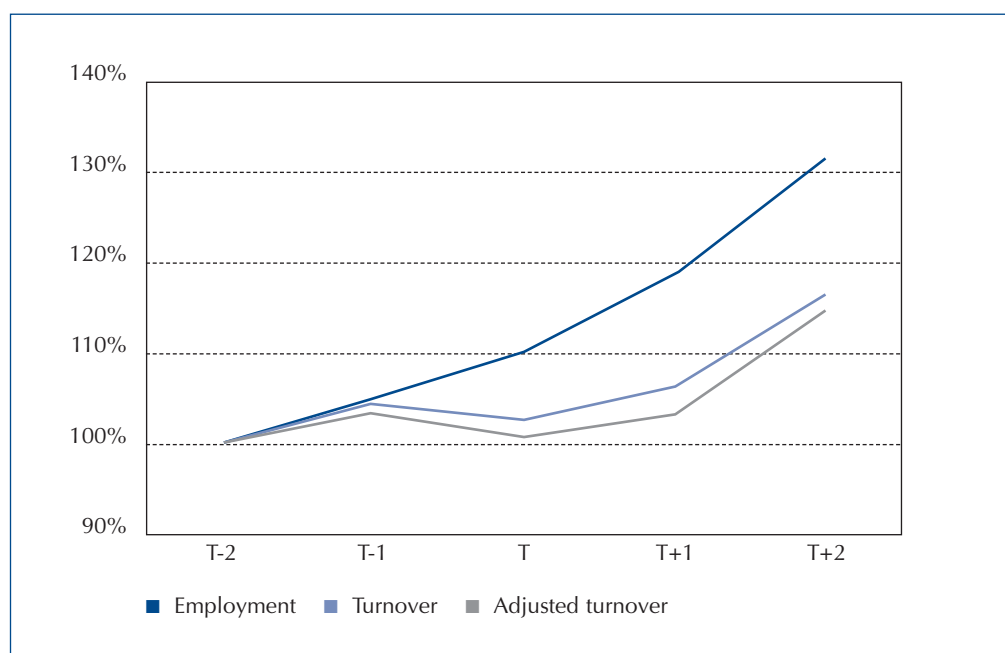
## Excuse: Buyouts of Family Businesses in Italy

A separate in-depth study of Italian family buyouts conducted by Professor Fabio Buttignon et al.<sup>7</sup> from the University of Padua finds similar results to those presented in this paper. In his study, Buttignon analysed in detail 21 family businesses of the 44 that had addressed succession through a private equity led buyout in Italy over the period 1995-2000.

For this sample, the turnover prior to the buyout ranged from €6.5 million to €1 billion, with an average turnover of €106 million. Excluding the largest two firms, the average turnover was €37 million. The average workforce in the year before the buyout and excluding the two largest cases was 159 employees. In 18 cases, there was no change in the management team after the buyout. In one case an external manager was introduced to the team and in only two cases the existing management team was replaced.

Employment increased on average by 31% between two years before the buyout and two years afterwards (Fig. 1). Over the same period, turnover increased by 16% and by 15% when adjusted for inflation and industry trends. Moreover, it can be seen from the sample, that the relative amount of debt used by the portfolio companies increased significantly after the buyout transaction, indicating a more sophisticated financial structuring.

Figure 1: Change in employment, turnover and adjusted turnover between two years prior to two years post buyout



Source: F. Buttignon et al.: "Family Business Investor Buyouts: The Italian Case", Working Paper, University of Padua, 2004

The private equity funds had already exited 11 out of the 21 companies by the end of 2003. Five of these exits were by trade sales; there was one IPO and three cases of re-financing. The non-exited deals at this point had been held for an average of 4.3 years, while the exited deals were held for an average of three years.

<sup>7</sup> F. Buttignon, M. Vedovato, P. Bortoluzzi, A. Gervasoni, R. Del Giudice, F. Bollazzi, C. Soppelsa, "Family Business Investor Buyouts: The Italian Case", Working Paper, University of Padua, 2004.



# Background Characteristics

## 1. Background Characteristics of the surveyed Businesses

This section aims to show the profile of family businesses that have gone through a private equity led succession. For the purpose of this study, family businesses are defined as firms having one of the following ownership structures:

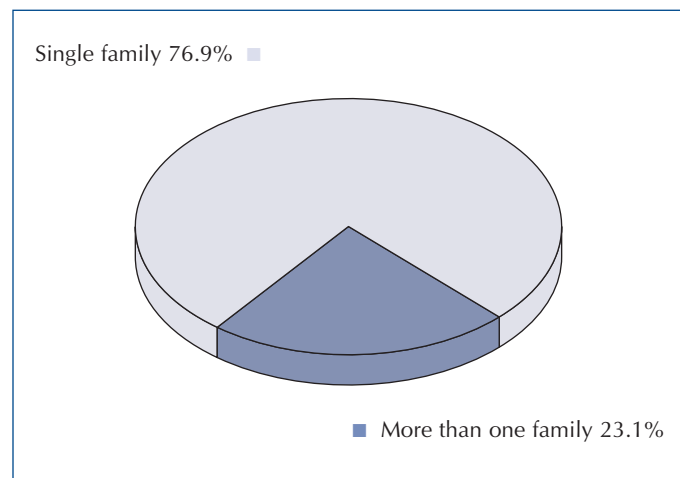
- More than 50% of the voting shares are owned or controlled by a single family related by blood or marriage
- The majority of the business is owned by more than one family (Multi-family company)

In the following, a closer look is taken at the ownership structure of the responding companies, as well as the history of the business and the shareholder structure before the buyout. Moreover, to ensure the representativeness of the results, the main activity of the responding companies is compared to the total population from the CMBOR database (see Appendix).

### 1.1 Most family businesses were owned by a single family

According to the definition of family business given in this paper, all companies surveyed were family businesses prior to the buyout, with a single family related by blood or marriage being the main shareholder in 76.9% of the cases. In 23.1% of the cases, shareholders came from more than one family (Fig. 2).

Figure 2: Ownership of the business



Source: CMBOR/EVCA

# Background Characteristics

## 1.2 The founders still owned 71% of the companies at the time of the buyout

In 71% of the cases, the company founders were the owners of the family business at the time of the buyout. The remainder of the businesses was either bought (14.5%) or inherited (13.7%) (Table 1).

Table 1: Pre-buyout route to ownership

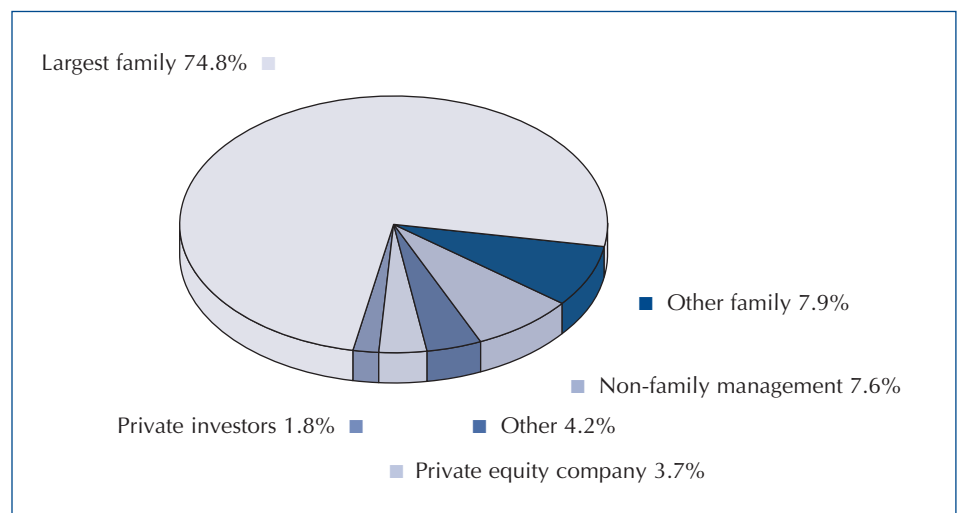
	No.	%
Founded	83	70.9
Bought	17	14.5
Inherited	16	13.7
Other	1	0.9
<b>Total</b>	<b>117</b>	<b>100.0</b>

Source: CMBOR/EVCA

## 1.3 Some 75% of shares held by the family owners prior to the buyout

Before the buyout, the largest family owned the majority of the business with an average share of 74.8%. Other family came second owning an average of 7.9% of the family business and non-family management came third owning on average 7.6% (Fig. 3). In 70.2% of the cases, the CEO of the company before the buyout was a member of the family, too.

Figure 3: Shareholders before the buyout



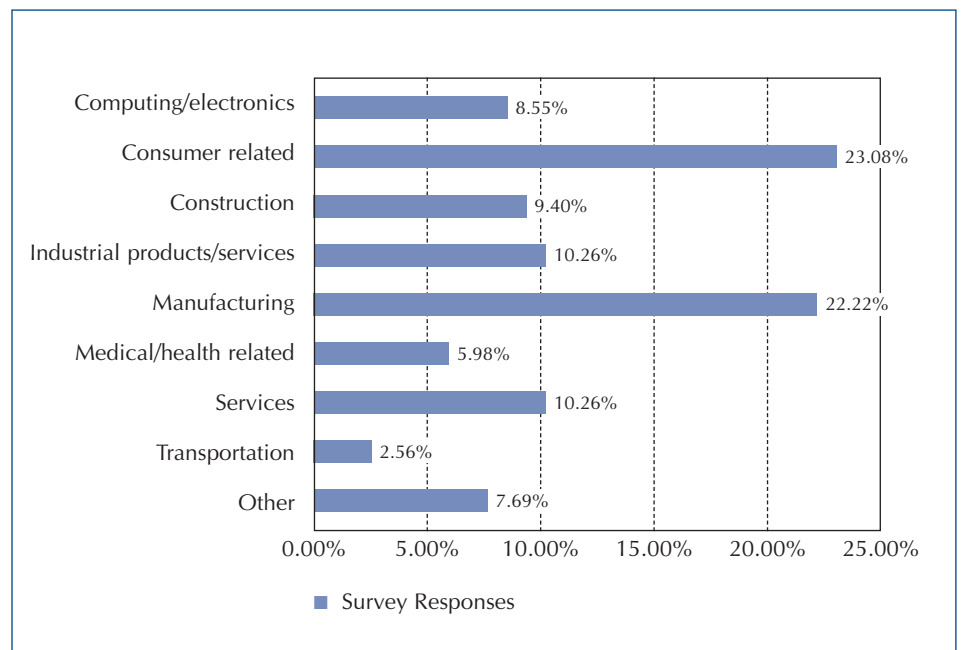
Source: CMBOR/EVCA

## 1.4 Survey participants operate over a broad range of industry sectors

Buyouts of family businesses occur across a wide spectrum of industry sectors. The consumer-related sector was the largest with 23.1% of the total respondents. This was followed by manufacturing (22.2%) and industrial products/services (10.3%) (Fig. 4). High technology sectors, covering biotechnology, computer hardware, software, services and semiconductors, electronics, telecommunications hardware, medical instruments and pharmaceutical activities accounted together for just under a tenth (9.4%) of the sample.

The distribution of the industry sectors represented in the survey has been compared to the CMBOR database for private equity backed family business buyouts between 1994 and 2003 (Appendix 2). The major differences between sample and population occur in Construction and Computing/electronics.

Figure 4: Sectors of main business activity



Source: CMBOR/EVCA

# Succession Planning

## 2. Succession Planning

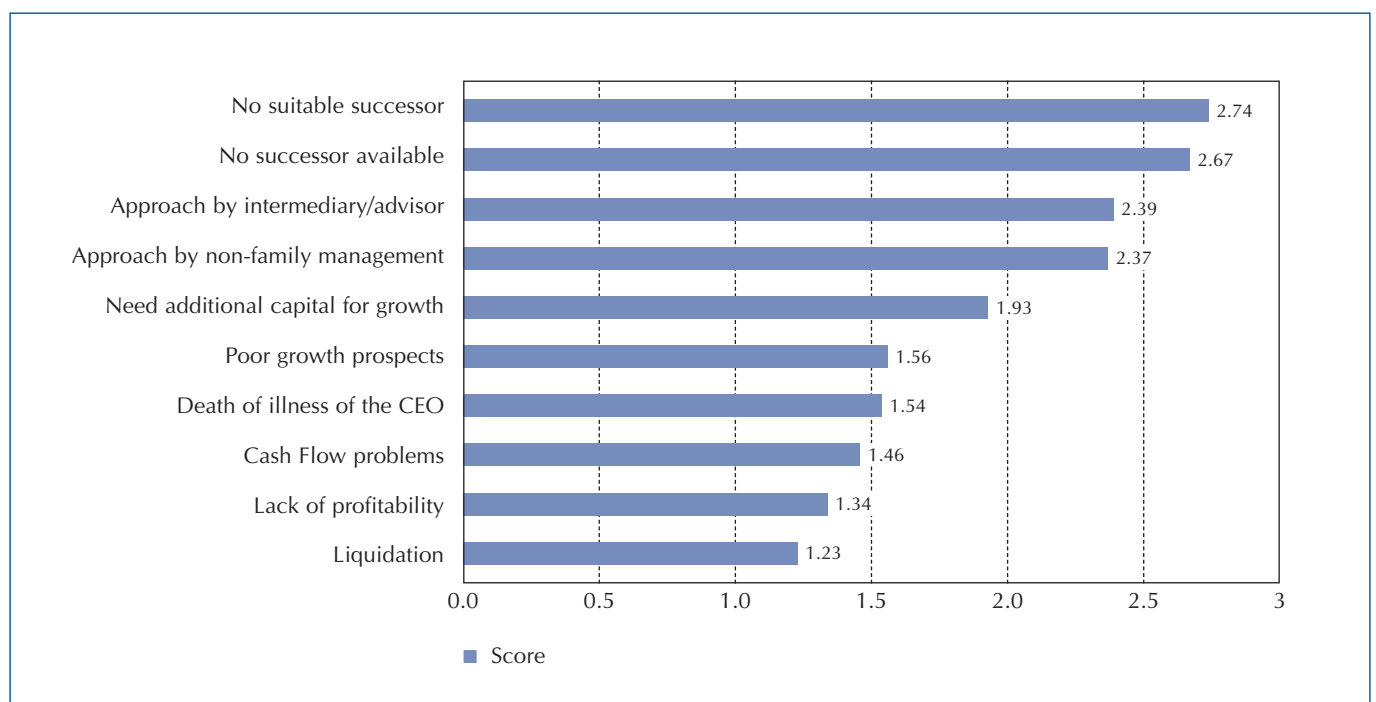
Many family businesses plan succession very late and often risk their survival in the long term. This section will therefore consider the process of succession planning. It will look into the reasons for selling a family business, the succession planning and the individual options considered. In addition, the role of both the management and the private equity fund are examined.

### 2.1 Lack of a successor is the principal reason to sell

Respondents were asked to rank a number of reasons for the sale of the family business, with 1 indicating very low and 5 indicating very high importance (Fig. 5).

Reasons given for the sale of the business included no suitable successor (average score of 2.74), no successor available (2.67), approach by intermediary/advisor (2.39) or approached by non-family management (2.37). Other reasons for the sale of the business included retirement, realisation of value and change of lifestyle.

Figure 5: Reasons for the sale of the business



Source: CMBOR/EVCA

### 2.2 Over 20% of family businesses do not formally plan succession

Relatively few of the surveyed companies planned succession well in advance. Moreover, a number of respondents admitted that formal succession planning either did not occur at all or did occur but very late in the life of the family firm.

Only 20% of the surveyed family businesses planned succession two years in advance and 13% more than two years. In 45.3% of cases the planning had taken place one year or less before succession. However, in 21.7% of the cases, there had been no succession planning at all (Table 2).

Table 2: Formal succession planning

	No.	%
There was no succession planning	25	21.7
Up to 1 year before the event	21	18.3
1 year before the event	31	27.0
2 years before the event	23	20.0
3 years before the event	9	7.8
4 years before the event	1	0.9
More than 4 years before the event	5	4.3
<b>Total</b>	<b>115</b>	<b>100</b>

Source: CMBOR/EVCA

### 2.3 Majority preferred selling to private equity funds

Respondents were further asked to rank a number of succession options considered by the vendor. Their preference is indicated on a scale from 1 (very low) to 5 (very high) for the options given in Table 3.

The preferred succession option was the sale to a private equity fund, followed by the sale to existing management with private equity backing.

The three options most often stated as not applicable to the respondents were to pass business on to next generation (33 respondents), sale to external management without private equity (30 respondents) and sale to existing management without private equity (27 respondents).

Table 3: Succession options

	No.	Mean
Sale to private equity fund	83	3.34
Sale to existing management with private equity	83	3.28
Engage advisor to sell business	83	3.24
Sale to/merger with another company	91	3.19
Sale to external management with private equity	80	2.89
Employ new management but retain ownership/control	80	2.30
Sale to external management without private equity	71	2.15
Sale to existing management without private equity	70	1.96
Pass business on to next generation	71	1.76

Source: CMBOR/EVCA

# Succession Planning

## 2.4 Management co-planned succession in 63% of cases

In around two thirds of the companies surveyed, the management was involved in succession planning. For a large proportion of those (26.7%), the vendor was driving the selling process. In a small number of cases, (7.8%) the management actually initiated the process by making an offer to the existing owner. However, in 33.6% of cases the management was not involved at all.

In 18.1% of the cases, the succession process was evenly balanced between management and vendor. In contrast, in 26.7% succession was discussed under the lead of the vendor (Table 4).

Table 4: Role of management in succession planning

	No.	%
Management not involved at all	38	33.6
Management and vendors discussed succession: process driven by the vendor	31	26.7
Management and vendors discussed succession: process evenly balanced	21	18.1
Management and vendors discussed succession: process driven by management	12	10.3
Management instigated the process by approaching vendor with an offer	9	7.8
Other	4	3.5
<b>Total</b>	<b>115</b>	<b>100.0</b>

Source: CMBOR/EVCA

## 2.5 In well over half the cases private equity funds contributed to succession planning

Private equity funds were actively involved in succession planning in 58% of the cases (Table 5). Of these, the private equity funds discussed succession with both vendor and management in 18.8% of the cases, whereas in 16.1% of the cases the fund discussed succession only with the management. For 15.2% of the companies the vendor approached the private equity fund to discuss succession and in 7.9% of the cases a proactive approach by the private equity fund was made.

Table 5: Role of private equity fund in succession planning

	No.	%
PE not involved at all	42	37.5
PE discussed succession with vendor and management	21	18.8
PE discussed succession with management	18	16.1
Vendor approached PE to discuss succession	17	15.2
PE made proactive approach to vendor before succession	9	7.9
Other	5	4.5
<b>Total</b>	<b>112</b>	<b>100.0</b>

Source: CMBOR/EVCA

# The Buyout Process

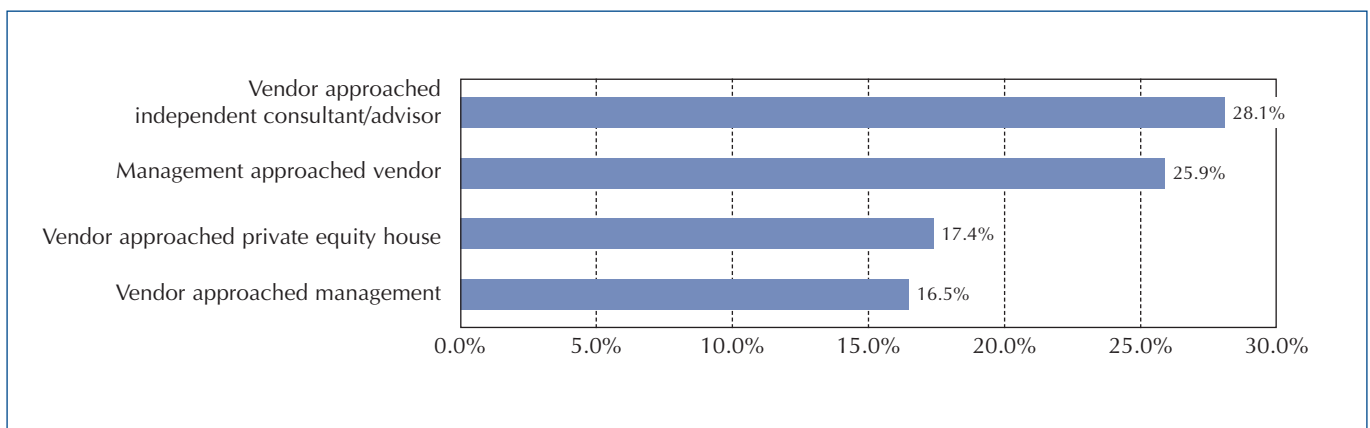
## 3. The Buyout Process

To gain a better understanding of the process of buying family owned businesses, the following section shows the initiation of the buyout, the motivation of the managers to undertake a buyout and the input of the private equity fund during the process. Furthermore, the nature of the sale process between the manager and the vendor is examined, along with the information sharing between both parties. Finally, there are some suggestions from the respondents illustrating how the process could have been improved.

### 3.1 In almost a third of the cases the vendor approached an independent consultant or advisor

When asked about the initiation of the deal, respondents stated most commonly that the vendor approached an independent consultant (28.1%) to initiate the sale of the family business. The management approaching the vendor followed almost as frequently (25.9%). The vendor approached the private equity fund directly in 17.4% of the cases and the management in 16.5% (Fig. 6).

Figure 6: Initiation of the buyout



Source: CMBOR/EVCA

### 3.2 Long-term faith in the company is the main motivation for managers to undertake a buyout

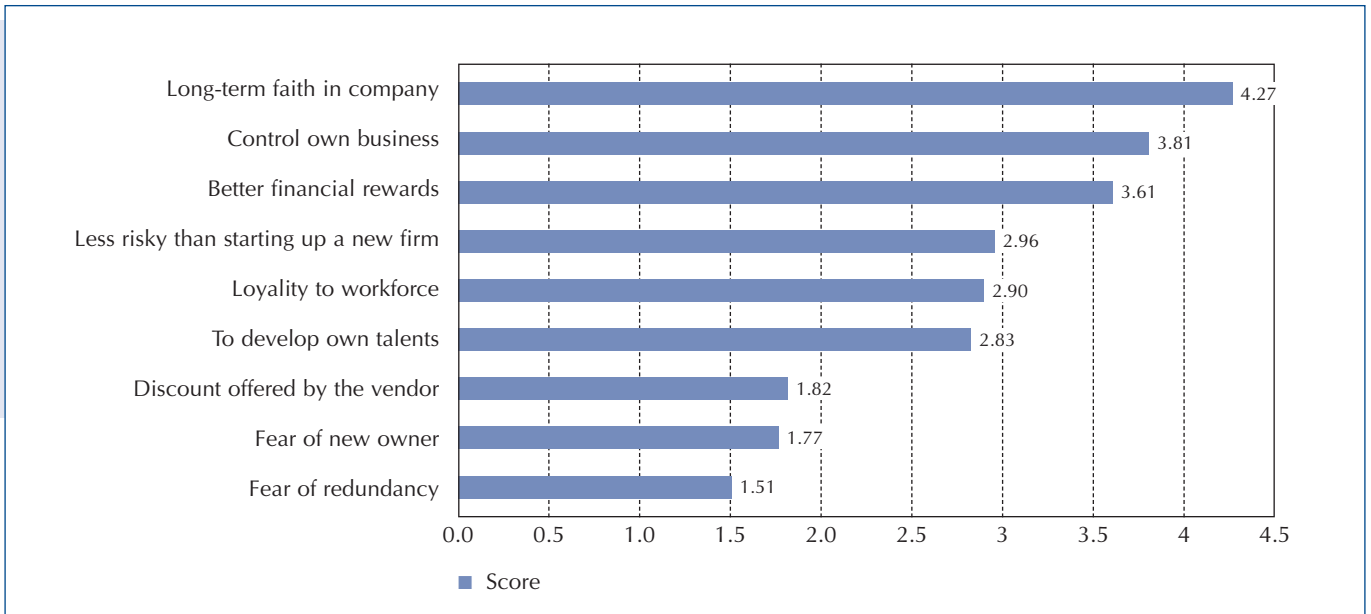
Respondents were further asked to rank a number of factors relating to the motivation for managers to undertake the buyout by scoring their importance on a scale between 1 (very low) and 5 (very high).

The main motivation for the managers was their long-term faith in the company, with an average score of 4.27. A desire to control their own business was the second most popular motivation (3.81) and better financial rewards came third (3.61). The list of motivational reasons surveyed is shown in declining order of importance in Fig. 7 on the next page.



# The Buyout Process

Figure 7: Main motivations for buyout



Source: CMBOR/EVCA

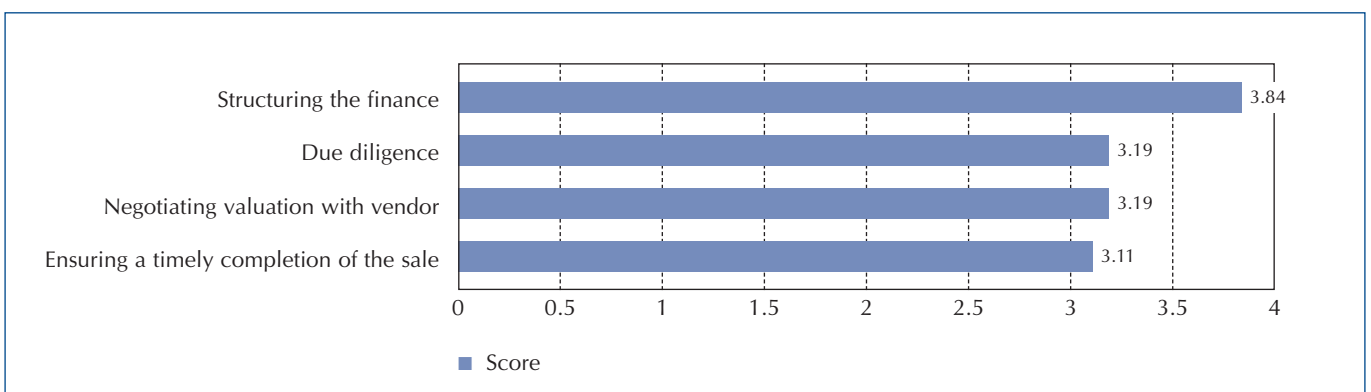
### 3.3 Private equity funds structured the finance and evaluated potential market growth

Companies were asked to rank a number of factors relating to the input of the private equity fund during the buyout process by scoring on a scale between 1 (no participation) to 5 (sole participation).

The most important contribution was in structuring the finance (Fig. 8). Second came the involvement in the due diligence process, followed by the funds contribution to negotiating the company valuation with the vendor.

The most important contribution of the private equity funds to the portfolio companies during the deal was evaluating potential market growth (Fig. 9). In second and third place were the support in reviewing the existing management and assistance in suggesting new management respectively.

Figure 8: Contribution related to the buyout process



Source: CMBOR/EVCA

Figure 9: Contribution related to the portfolio company



Source: CMBOR/EVCA

### 3.4 The management and the vendor mutually agreed on the price in more than half of the cases

Over half of the respondents (52.6%) reported that the sale price was mutually agreed on by the management and the vendor (Table 6), underlining a relatively balanced negotiation process. More than a quarter of respondents stated that the vendor proposed a fixed price that maximised his/her valuation (26.7%), although 11.2% felt that the fixed price proposed by the vendor was fair and in the best interests of the company.

Table 6: Sale process between management and vendor

	No.	%
A mutually agreed price was negotiated	61	52.6
Vendor proposed a fixed price that maximized his/her valuation	31	26.7
Vendor proposed a fixed but fair price that was in the best interests of the company	13	11.2
Management proposed a fixed price	5	4.3
Vendor required management to match an outside bid	3	2.6
Vendor offered company to management at lower price than external bid	1	0.9
Other	2	1.7
<b>Total</b>	<b>116</b>	<b>100.0</b>

Source: CMBOR/EVCA

# The Buyout Process

## 3.5 Management and vendor shared underlying information equally in close to 43% of the cases

It is often assumed that there is significant information asymmetry between vendor and management at the time of a buyout. Results indicate that this is not the case in the majority of buyouts analysed here, although there are still significant signs of information asymmetry found amongst the respondents.

Almost half of companies who answered this question (42.6%) indicated that vendor and management shared relevant information equally, although, in a similar number of cases (41.8%) the vendor controlled all or most of the relevant information (Table 7).

Table 7: Information sharing between management and vendor

	No.	%
Vendor and management shared relevant information equally	49	42.6
Vendor controlled all the relevant information	24	20.9
Vendor controlled most of the relevant information	24	20.9
Management controlled most of the relevant information	15	13.0
Management controlled all relevant information	3	2.6
<b>Total</b>	<b>115</b>	<b>100.0</b>

Source: CMBOR/EVCA

## 3.6 Need for active and faster commitment from participants, but less outside advisors and lawyers

When asking an open question on how the buyout process could have been improved, suggestions from 56 respondents were received (48%) (Table 8 - individual responses have been grouped together).

Many respondents suggested that the process could have been improved if all three participants, i.e. vendor, management and private equity fund, had been more actively involved in the buyout process. In addition, the length of time taken to complete the acquisition process was deemed too long in some instances. Some reasons given for the unduly lengthy process were that advisors took too long; the legal process was too complex, the vendor was not organised enough and due diligence was excessive. A number of firms mentioned there should have been less involvement by lawyers and advisors, which ultimately leads to increased costs and time to completion.

Others stated that the management should have had more access to information and that this could have been enhanced by better record keeping. An improved relationship between the vendor and the management overall was further mentioned to avoid difficulties and reduce transaction time. Enhanced financial advice was also a common suggestion with some firms feeling that they were unsure of the financial options pre buyout.

Table 8: How the process could have been improved

Improvement Suggestion	%
More involvement of participants	13.7
None (process went well)	13.7
Reduce time	9.8
Less legal/advisor involvement	9.8
Improve financial advice	7.8
Improve private equity fund's input	7.8
Improve information for management	7.8
Improve due diligence	5.9
Reduce legal costs	5.9
Improve communication between vendor and management	3.9
Improve market evaluation	2.0
Improve valuation of company	2.0
Improve understanding of the business	2.0
Reduce costs	2.0
More information on due diligence	2.0
Improve accounting transparency	2.0
Improve communication between private equity fund and management	2.0

Source: CMBOR/EVCA

# After the Buyout

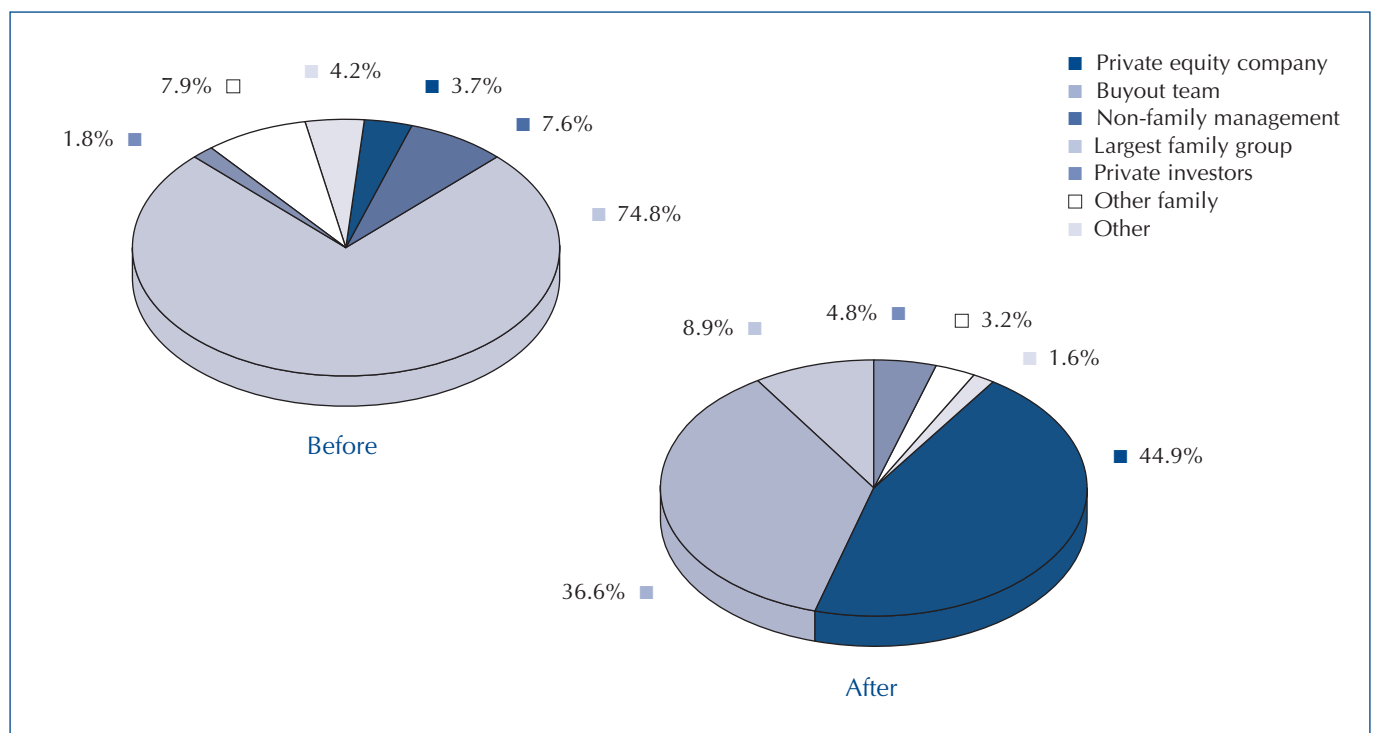
## 4. After the Buyout

This section provides an overview of the company structures following the buyout. The shareholdings before and after the buyout are compared in detail, as well as changes in the buyout team over time and the involvement of family members after the acquisition.

### 4.1 Private equity firms take an average 45% stake and management close to 37%

A comparison of the stakes held by different shareholders before and directly after the buyout is given in Fig. 10. After the buyout the private equity fund became the largest shareholder, owning on average 44.9% of the company. The second largest shareholder became the buyout team, owning on average a 36.6% stake. It is important to note that family still owned more than 10% after the buyout, indicating their continuing involvement.

Figure 10: Shareholding before and directly after the buyout



Source: CMBOR/EVCA

The large stake held by the management after the buyout is in agreement with the fact that the majority of the buyouts were of smaller companies with 100 employees or fewer. In such cases, the management often has the financial means to obtain a larger stake.

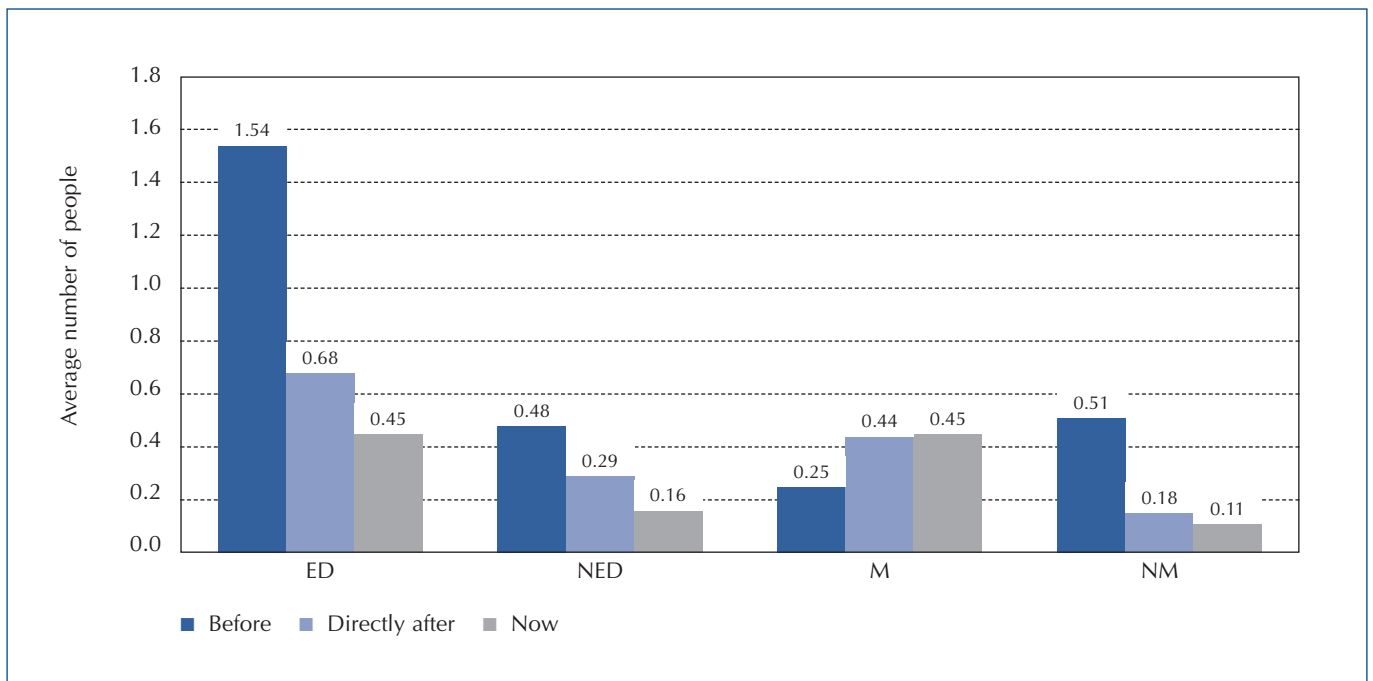
### 4.2 A typical buyout management team consist of four managers

Respondents were asked about the buyout team and changes therein following the deal. On average, there were four equity holding managers in the buyout team, but after the buyout one person left and two people joined as equity holders. In addition, following the buyout, there was one non-executive director representing the private equity fund.

### 4.3 Family members give up on their executive positions in favour of managerial positions

The average number of family members employed by the business before the buyout, directly after the buyout and at time of the survey is shown in Fig 11. The number of family executive directors (ED), non-executive directors (NED) and non management (NM) fell over time. However, the number of family members in managerial positions (M) has risen since the buyout. Four companies reported that they had one family member in an advisory/ambassadorial role directly after the buy-out and two companies reported that they had one family member in this same role at the time of the survey.

Figure 11: Family members in functional positions



Source: CMBOR/EVCA

## 5. Corporate and Business Strategy of the Buyout

In this section, the strategic objectives of the business are compared before and after the buyout. In addition, different management styles are also analysed.

### 5.1 Companies become more cash flow oriented after the buyout

Respondents were asked to rank a number of factors relating to their business strategy, both before the buyout and at the time of the survey, by scoring their importance on a scale between 1 (very low) to 5 (very high) (Table 9).

Before the buyout, the three most important strategic objectives were net profit, cash flow and sales growth. The next most important strategic objectives were long-term profitability, market value increment and return on shareholder equity. Following the buyout the same six strategic objectives were still the most important. However, cash flow from operations was now the single most important objective, followed by net-profit from operations and long-term profitability of the company. Interestingly all finance and growth-related objectives scored more highly after the buyout than they did beforehand.

Table 9: Key strategic issues

Criteria	Before		Currently	
	No.	Mean	No.	Mean
Cash flow from operations	111	4.19	112	4.72
Net profit from operations	112	4.38	114	4.64
Long-term profitability	111	4.14	112	4.48
Sales growth	109	4.17	114	4.32
Return on shareholder equity	110	3.38	111	4.06
Market value increment	110	3.39	114	4.06
Market share expansion	111	3.28	113	3.65
Short-term profitability	110	3.18	112	3.50
Capital restructuring	109	2.26	110	2.85
To accumulate family wealth	108	3.20	108	2.58
To increase employment	108	2.14	110	2.15

Source: CMBOR/EVCA

### 5.2 Flat management styles and improved communication after the buyout

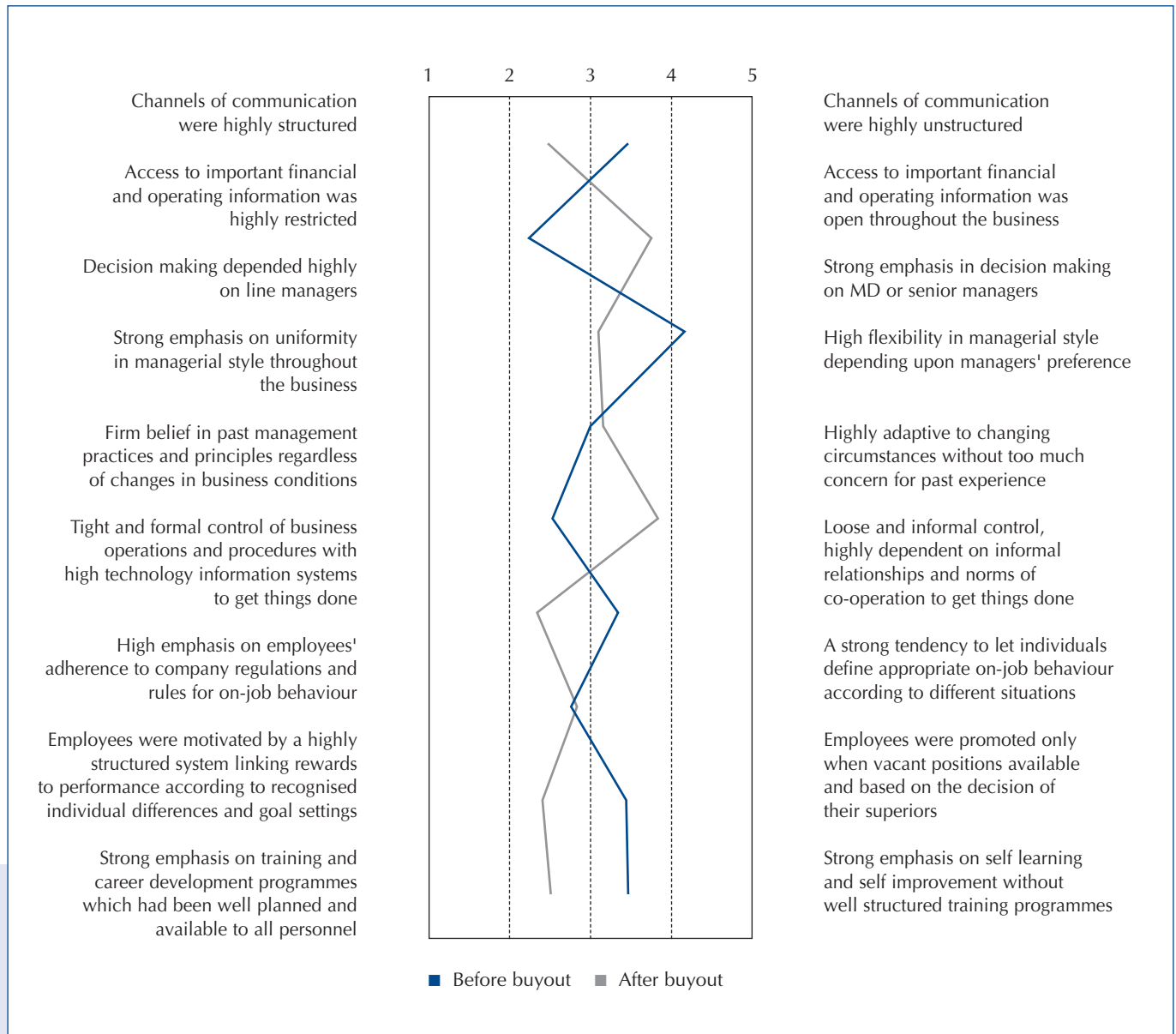
Respondents were asked to rank a number of factors relating to management styles before and after the buyout by scoring on a scale of 1 to 5. A score of less than 3 indicates the respondent favours the statement on the left and a score of greater than 3 indicates the respondent favours the statement on the right. A score of 3 indicates neutrality (Fig. 12).

The main points are that before the buyout there was a strong emphasis in decision making by the CEO or senior managers and channels of communication were unstructured.



After the buyout, the situation changed. The management style became highly adaptive to changing circumstances without too much concern for past experience. Also, important financial and operating information became more accessible throughout the business, increasing the adaptive nature of the company. Moreover, the control of business operations and the use of information technology in the company expanded after the buyout.

Figure 12: Comparison of management styles before and after the buyout



Source: CMBOR/EVCA

# Performance of the Company

## 6. Performance of the Company

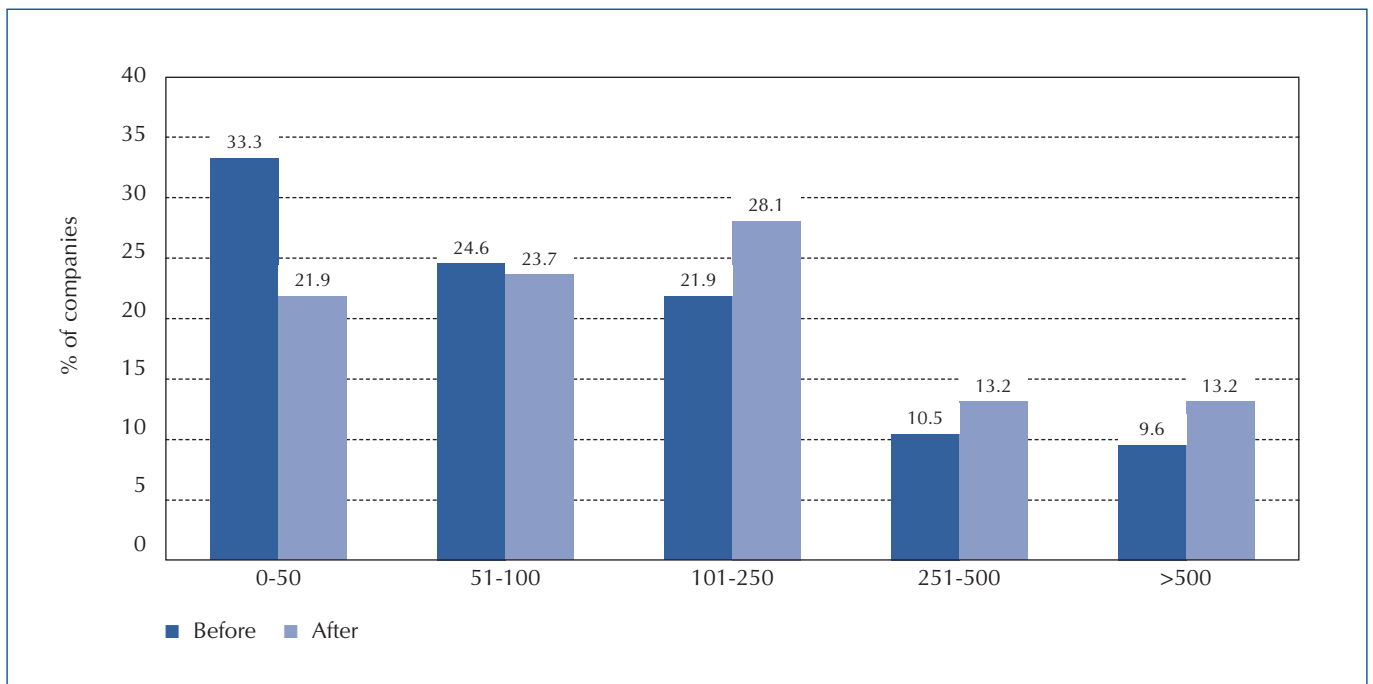
In this chapter the financial and non-financial performances of the portfolio companies before and after the buyout are compared. This includes, in particular, the development of the number of employees, turnover and profit. In addition, the export activity of the company inside and outside the European Union is examined.

### 6.1 Employment increases on average by 67.3% to 440 employees

The businesses are compared on the basis of the number of full-time equivalent employees before and after the buyout (Fig. 13). Overall, the percentage of companies with few employees decreased after the buyout, while the percentage of companies with a higher number of employees increased.

Before the buyout, 57.9% of companies had 100 or fewer employees, this fell to 45.6% after the buyout. In contrast, only 20.1% of companies had over 250 employees before the buyout but this increased to 26.4% after the buyout. The average number of employees before the buyout was 263 and afterwards this figure rose to 440, which represents 67.3% growth.

Figure 13: Comparison of numbers of employees per company



Source: CMBOR/EVCA

The average growth in the number of employees for companies of different sizes has been calculated by comparing figures before and after the buyout (where 'after' refers to the situation at the time of the survey or just before any exit, if exited) (Table 10). The greatest average growth was observed among companies that had 50 or fewer employees before the buyout (388%). This was followed by the growth measured for larger companies with over 500 employees (151%).

Table 10: Increase in number of employees by company size

Company Size (Before buyout/in)	No. of companies	Increase (%)
0-50 Employees	38	388.1
51-100 Employees	28	24.3
101-250 Employees	25	50.0
251-500 Employees	12	1.8
>500 Employees	11	151.1

Source: CMBOR/EVCA

## 6.2 Turnover grew annually by 15.4% and PBIT by 11.3% after the buyout

Financial performance was gauged by measuring change in turnover and the profit before interest and tax (PBIT) as a percentage of turnover. The respondents provided the annual turnover and PBIT figures, where 81.3% of the accounts were consolidated.

For each company the percentage change in turnover was calculated for each year starting from the year before the buyout until three years afterwards (year 0 represents the year of the buyout). From this an average percentage change for all buyouts was derived. PBIT as a percentage of turnover was calculated for each company over the same period of time and again an average was produced for each year.

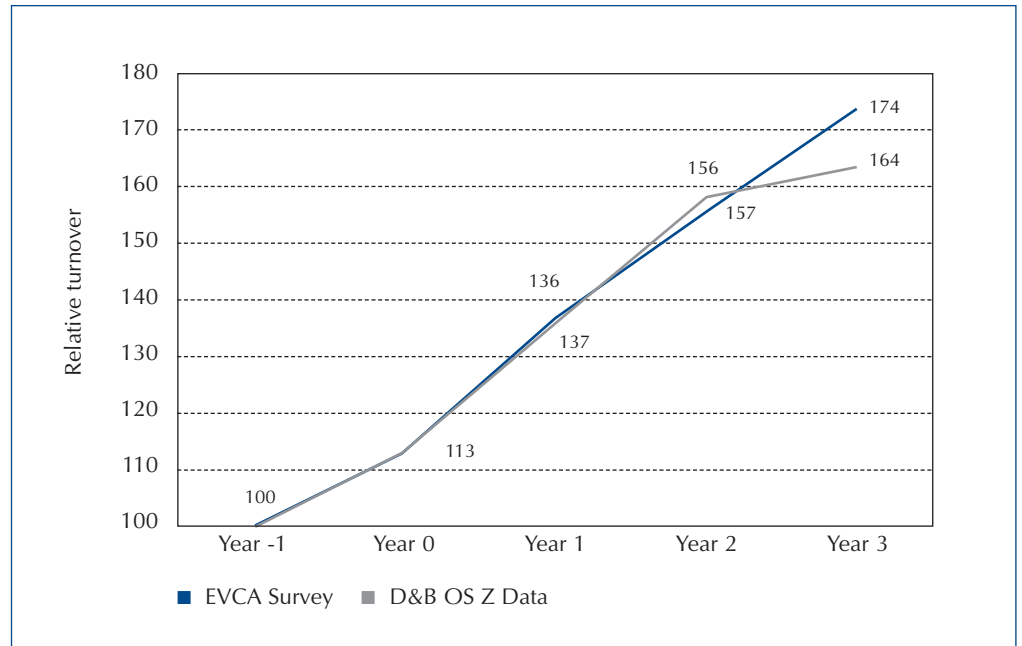
The same procedure was carried out on a sample of 224 family buyouts sourced from Dun&Bradstreet, OneSource and Zephyr using exactly the same principles (companies were selected based on whether the information was available for them).

Using the results obtained above the turnover was benchmarked to 100, in order to compare the two different data sources directly. Turnover is shown in Fig. 14 and PBIT, based on the benchmarked turnover, is shown in Fig. 15 (see Appendix 1 for more details).

Turnover increased each year and the compound annual growth rate (CAGR) was 15.4% for the three years post buyout. The PBIT CAGR was 11.3% for the three years post buyout. The results for the Dun&Bradstreet, OneSource and Zephyr companies are very similar. Turnover increased every year and the post-buyout CAGR was 13.3%. For PBIT the post-buyout CAGR was 10.3%. By the end of year three, the survey respondents were on average more profitable than the companies reviewed by Dun&Bradstreet, OneSource and Zephyr.

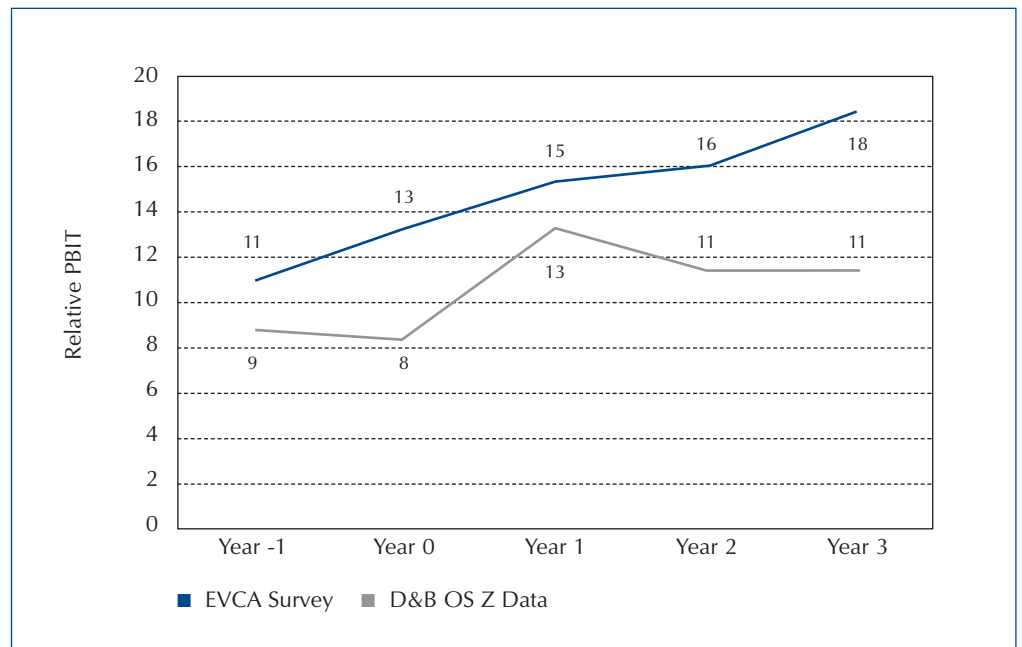
# Performance of the Company

Figure 14: Change in turnover



Source: CMBOR/EVCA

Figure 15: Change in PBIT



Source: CMBOR/EVCA

### 6.3 Export activities increase from 23.9% to 28.4% of sales

When looking at the export activities of the surveyed companies, 73% were exporting their products before the buyout compared to 80% after the buyout.

The responding companies experienced a modest increase in their overall exporting activities between the year before the buyout and at time of the survey, expressed as a percentage of total sales (Table 11). In the year before the survey, the share of output being exported had risen to 28.4% of sales, from 23.9% the year before the buyout. In particular exports outside of the European Union increased by 32% after the buyout.

Table 11: Comparison of exports before and after the buyout (% of sales)

	Inside European Union	Outside European Union	Total exports
Year before buyout	15.5	8.4	23.9
After buyout	17.3	11.1	28.4

Source: CMBOR/EVCA

### 6.4 One third of the companies surveyed state that without private equity they could not have continued as an independent entity

Respondents indicated that without the private equity investment the company could not have continued as an independent entity in 32.7% of the cases. Another 31% thought that succession would not have taken place. Furthermore, 11.5% of the companies surveyed considered that they would have ceased to exist without private equity backing, while in 17.7% of the cases the company would have developed more slowly (Table 12).

Table 12: Company development without private equity

	No.	%
Could not have continued as an independent entity (would have been acquired by a larger company)	37	32.7
Succession would not have taken place (i.e. business would have remained in family)	35	31.0
Would have developed more slowly as an independent entity	20	17.7
Would have ceased to exist	13	11.5
Would have developed in the same way as an independent entity	7	6.2
Would have developed faster as an independent entity	1	0.9
<b>Total</b>	<b>113</b>	<b>100.0</b>

Source: CMBOR/EVCA

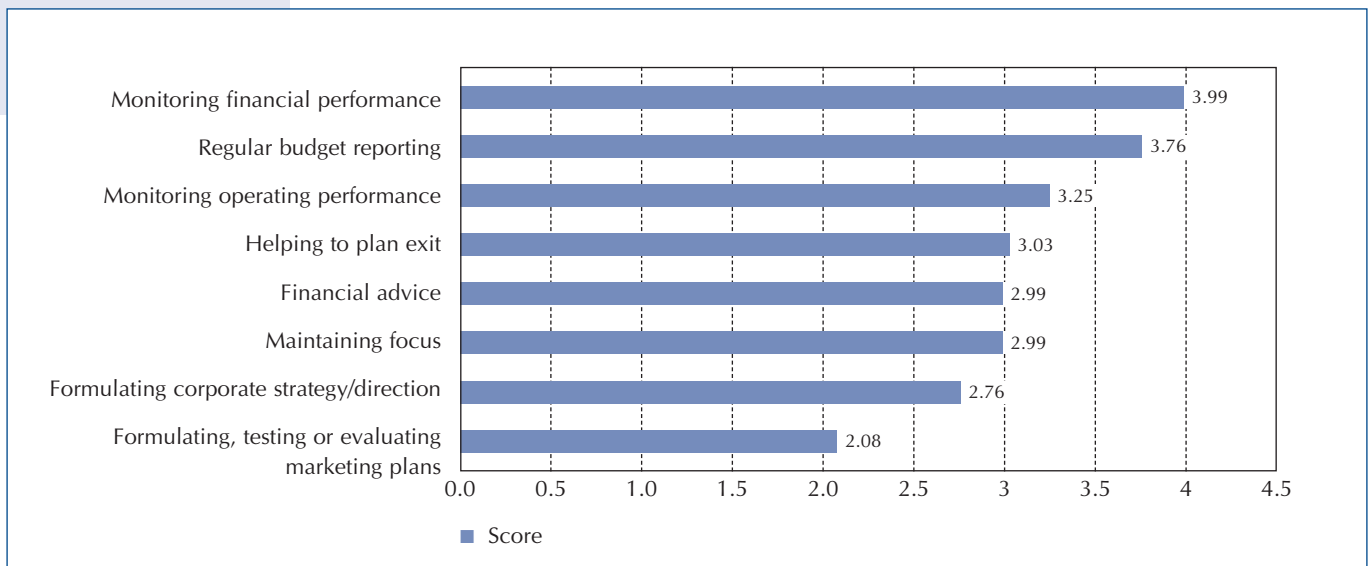
# Relationships

## 7. Relationships with Private Equity Funds

Companies were asked to rank a number of factors relating to the input of the private equity fund by scoring on a scale between 1 (no participation) to 5 (full participation). The areas of interest have been divided into financial/operational (Fig. 16) and non-financial (Fig. 17).

The three most important areas of financial and operational contribution are monitoring of financial and operating performance as well as regular budget reporting. Helping to plan an exit was seen as another important area of input. Almost as important were financial advice and support in maintaining focus.

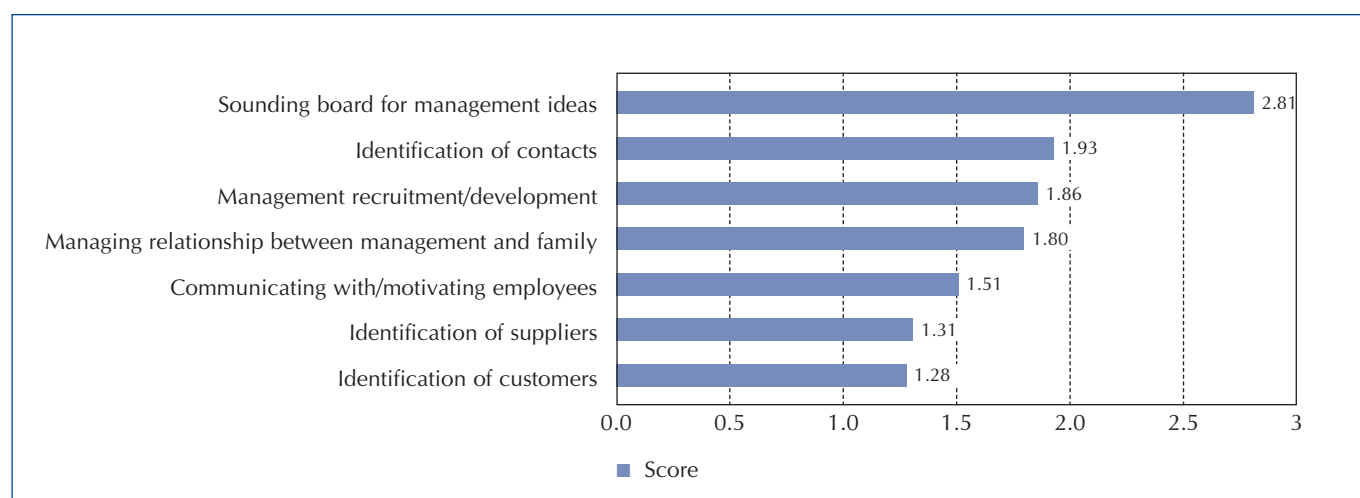
Figure 16: Financial/operational contribution of private equity funds



Source: CMBOR/EVCA

The three most important non-financial contributions of private equity funds are acting as a sounding board for management ideas, identification of contacts and management recruitment/development. The role of private equity funds in the communication with and motivation of the company's employees was also stressed. Moreover, managing the relationship between the management and family was seen as important. This has also been raised when respondents were asked for possible improvements to the buyout process (see Section 3.6).

Figure 17: Non-financial contribution of private equity fund



Source: CMBOR/EVCA

As a follow up, the respondents were asked in an open question what they considered to be the single most important contribution of the private equity funds, other than the provision of funding. Answers from 91 out of 117 (78%) respondents were received (Table 13).

The most important contribution of the private equity funds was considered to be the provision of strategic advice. Financial advice and financial contacts came second. Other areas of contribution featured prominently were to provide focus and support to the business as well as allowing management the freedom to run the company without interference. The contribution in terms of networking opportunities/connections, providing management expertise and help with exit planning were also thought to be important. These findings are much in line with the generally accepted assumption that private equity has a significant impact on social and economic developments.

Table 13: Contribution of private equity fund to the business

Comment	%
Strategic advice	15.2
Financial advice and financial contacts	8.7
Focus and support	6.5
Freedom to run company without interference	6.5
Networking opportunities/connections	5.4
Providing management expertise	5.4
Help with exit	5.4
None	5.4
Help with appointing/restructuring	4.3
Sounding board for management ideas	4.3
Providing credibility/status	3.3
M&A Expertise	3.3
Monitoring performance	3.3
Focus on cash generation	2.2
Making the company more professional	2.2
Knowledge of industry	1.1
Other	17.4

Source: CMBOR/EVCA



# Conclusion

## 8. Conclusion

Given the important role played by family businesses in the European economy and the lack of suitable successors in many, the preservation of those enterprises and jobs will become an important matter over the coming years. As the above research has shown, private equity led buyouts can play an important role in maintaining family-owned businesses. The lack of a successor has been the key reason for the family businesses surveyed to undertake a private equity led buyout. Some 31% of the respondents stated that succession would not have taken place without private equity investment and in 32.7% of cases the company would no longer have existed as an independent entity.

Apart from providing the necessary finance to allow for the preservation of a family business in succession difficulties, a private equity fund also helps in reshaping the company after the buyout. In particular, respondents stated that the private equity funds' function as a sounding board for management ideas, providing business and industry contacts and assisting in the development of the management team. The monitoring of financial and operating performance as well as regular budget reporting were further stated as key contributions. Additionally, respondents valued the private equity funds' role as facilitators between both the owners of the family business and the management.

Performance of the family businesses surveyed improved following the buyout. Turnover in the responding companies rose by a compound annual growth rate of 15.4% in the three years following the buyout and PBIT grew by 11.3%. Additionally, the average number of employees increased by 67.3%, from an average of 263 employees per company before the buyout to 440 employees afterwards. Finally, the surveyed companies increased their exports after the buyout and in particular those exports to countries outside the European Union.

Hence, performance did not suffer from the change in ownership, but improved following the buyout. One reason for this might be the (non-family) managements' increased interest in the company – which is often seen as a driver for long-term growth and business prospects. Input from the private equity funds is also important, as their experienced professionals advise on the future strategy of the company. Moreover, the former family owners were often still involved in the business following the transaction, adding a degree of stability to the company.

However, the survey also highlights some areas to which the different parties should pay more attention. The succession process for example occurs often very late in the life of a family firm, mostly less than two years before succession itself. A family business owner should not underestimate the risk for the company's continued existence if appropriate and timely succession planning has been neglected. At the same time, the management is often not involved in the planning (33.6% of the surveyed cases), showing that there is room for more interaction. The private equity funds, on the other hand, should try to facilitate the buyout process and shorten the procedures and time involved. Moreover, it might be useful for the private equity fund to explain processes more clearly to the different parties and become even more proactive during the buyout process. Finally, transparency and information sharing between all three parties; the vendor, the management and the private equity fund, is of utmost importance in order to assess the potential of the company and to establish a common business strategy for the future.

# Appendix 1

## Appendix 1: Survey Methodology

### The sample

The sample for the survey was derived from the Centre for Management Buy-out Research (CMBOR) database, which contains details of over 20,000 management buyouts across Europe. The group of interest was family/private venture capital backed deals completed between 1994 and 2003.

The survey was undertaken between June and September 2004. A pilot was carried out initially since the questionnaire was new and had not been previously tested. It was sent to a selection of family companies and six completed questionnaires were returned. After analysing the replies, one question was modified slightly.

The questionnaire was then translated into French, Spanish, German and Italian and was mailed to the companies identified using information from the CMBOR database and EVCA. Two weeks after the first mailing, a reminder was sent and this was followed up by telephone calls a week later from CMBOR. Further reminders were administered from EVCA. In total, 117 companies replied out of 1,645 contacted, a response rate of 7.1%.

The final number of responses split by year of buyout is shown in Table 14.

Table 14: Response by year of buyout

Year	Total
1994	3
1995	8
1996	7
1997	12
1998	7
1999	13
2000	7
2001	14
2002	27
2003	19
<b>Total</b>	<b>117</b>

Source: CMBOR/EVCA

# Appendix 1

## Turnover/PBIT calculations

Financial performance was gauged by measuring percentage change in turnover and the profit before interest and tax (PBIT) as a percentage of turnover. In order to compare one company data against another it was necessary to start from the same turnover. Turnover was thus benchmarked to 100 and the percentage changes derived from the data sets were used to calculate average turnover and PBIT for the whole sample for each year (relative to the starting point of 100).

Table 15: Turnover/PBIT calculations for figures 14/15

EVCA	Year -1	Year 0	Year 1	Year 2	Year 3	CAGR
Turnover	100.00	113.29	136.22	156.30	174.10	15.4%
% change (from survey)	13.29	20.24	14.74	11.39		
PBIT	11.13	13.37	15.38	16.08	18.42	11.3%
% of turnover (from survey)	11.13	11.80	11.29	10.29	10.58	

D&B OS Z	Year -1	Year 0	Year 1	Year 2	Year 3	CAGR
Turnover	100.00	112.70	136.73	157.32	163.71	13.3%
% change (from data)	12.70	21.32	15.06	4.06		
PBIT	8.84	8.25	13.21	11.34	11.08	10.3%
% of turnover (from data)	8.84	7.32	9.66	7.21	6.77	

For the EVCA data set:

$$\text{Turnover for Year 1} = 113.29 + ((113.29 * 20.24)/100) = 136.22$$

$$\text{PBIT for Year 0} = (113.29 * 11.8)/100 = 13.37$$

# Appendix 2

## Appendix 2: Analysis of Responses by Business Sector

The relationship between business sectors of the companies in this survey and those in the CMBOR database are shown in Table 16. These industrial sectors have then been combined further to produce the data shown in Figure 18.

The largest differences occur in construction, computing/electronics and services.

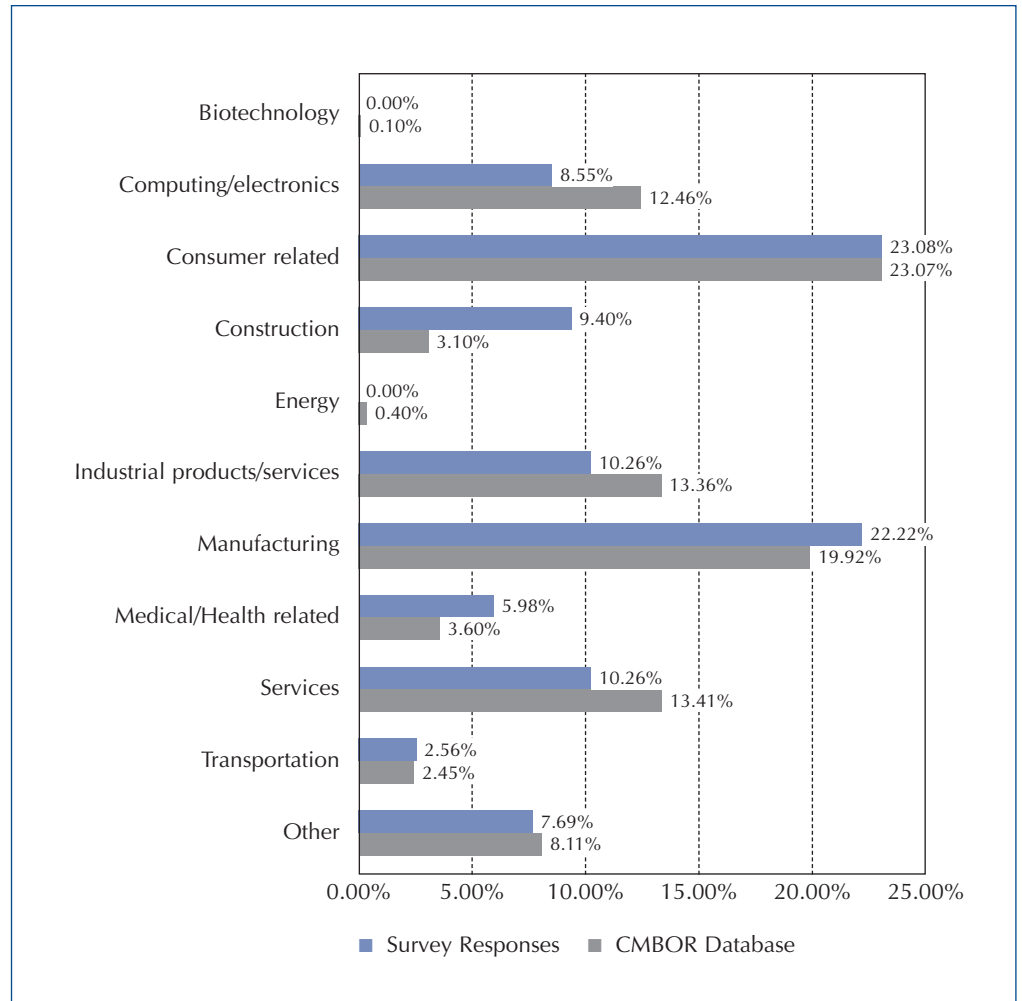
Table 16: Comparison of industry sectors

Survey	%	CMBOR Database	%
Biotechnology	0.00	Biotechnology	0.10
Computer: Hardware	0.85	Computer: Hardware	0.95
Computer: Semiconductor	0.00		
Computer: Services	1.71	Computer: Services	2.25
Computer: Software	0.00	Computer: Software	1.90
Internet technology	0.00	Internet technology	0.45
Electronics	4.27	Electrical eng. & Electronics	4.80
Telecommunications: Carriers	0.00	Telecommunications	2.10
Telecommunications: Hardware	0.00		
Communication (other)	1.71		
Consumer: Other	3.42	Retail distribution & repair	6.81
Consumer: Retail	9.40	Media	3.40
		Paper, printing & publishing	4.65
Food & Drink	5.98	Food	4.50
		Drink	0.45
Hotels Catering & Leisure	4.27	Hotels, Catering & Leisure	3.25
Construction	9.40	Construction	2.90
		Real Estate	0.20
Energy	0.00	Energy	0.25
		Extraction of ore and minerals	0.15
Industrial automation	2.56	Mechanical & instrument eng.	6.71
Industrial products/services	7.69	Wholesale distribution	6.66
Manufacturing (other)	17.95	Leather, footwear & clothing	2.90
		Manufacturing - mixed	0.25
		Metal goods	0.90
		Other manufacturing	11.61
		Vehicles & shipbuilding	2.35
Chemicals and materials	4.27	Chemicals & manufacturing	1.90
Medical: Healthcare	3.42	Medical: Healthcare	2.65
Medical: Instruments	0.00		
Medical: Pharmaceutical	2.56	Medical: Pharmaceutical	0.95
Services (other)	8.55	Business services, leasing	12.16
Financial Services	1.71	Banking, insurance & finance	1.25
Transportation	2.56	Transport & communication	2.45
Other	6.84	Metals	1.70
		Non-metallic mineral products	1.05
		Textiles	1.70
		Timber, furniture	2.50
		Tobacco	0.00
		Unknown	0.65
Agriculture	0.85	Agriculture, Forestry, Fish	0.50

Source: CMBOR/EVCA

# Appendix 2

Figure 18: Industry sectors from survey compared to CMBOR database



Source: CMBOR/EVCA

# Appendix 3

## Appendix 3: Definitions

### Buyout

A buyout is a transaction in which a business, business unit or company is acquired from the current shareholders (the vendor). Variations of this include:

- A management buyout (MBO), i.e. a buyout in which the target's management team acquires an existing product line or business from the vendor with the support of private equity funds;
- A management buyin (MBI), i.e. a buyout in which external managers take over the company and financing is provided to enable a manager or group of managers from outside the target company to buy into the company with the support of private equity funds;
- A buyin-management-buyout (BIMBO), i.e. a combination of a management buyin (MBI) and a management buyout (MBO). In a BIMBO, an entrepreneurial manager or group of external managers financed by venture capitalists buys into a company and teams up with members of the target management team to run it as an independent business.
- An institutional buyout (IBO), i.e. where outside financial investors (e.g. private equity funds) buy the business from the vendor, while existing management may be involved from the start and purchase a small stake, or, alternatively, the investor may install its own management;
- A leveraged buyout (LBO), i.e. a buyout in which the target company's capital structure incorporates a particularly high level of debt, much of which is normally secured against the company's assets.

### Exit

Liquidation of holdings by a private equity fund. Among the various methods of exiting an investment are: trade sale; sale by public offering (including IPO); write-offs; repayment of preference shares/loans; sale to another venture capitalist; sale to a financial institution. Variations include:

- Buyback, i.e. a corporation's or family's repurchase of its own stock or bonds.
- IPO (Initial Public Offering), i.e. the sale or distribution of a company's shares to the public for the first time. An IPO of the investee company's shares is one the ways in which a private equity fund can exit from an investment.
- Secondary sale, i.e. the sale of private or restricted holdings in a portfolio company to other investors.
- Trade sale, i.e. the sale of company shares to industrial investors.

### Family business

For the purpose of this study, family businesses are defined as firms having one of the following ownership structures:

- More than 50% of the voting shares are owned or controlled by a single family related by blood or marriage
- The majority of the business is owned by more than one family (multi-family company)

# Appendix 3

## Private equity

Private equity provides equity capital to enterprises not quoted on a stock market. Private equity can be used to develop new products and technologies, to expand working capital, to make acquisitions, or to strengthen a company's balance sheet. It can also resolve ownership and management issues. A succession in family-owned companies, or the buyout and buyin of a business by experienced managers may be achieved using private equity funding. Venture capital is, strictly speaking, a subset of private equity and refers to equity investments made for the launch, early development, or expansion of a business.

## Private equity fund

A private equity investment fund is a vehicle for enabling pooled investment by a number of investors in equity and equity-related securities of companies (investee companies). These are generally private companies whose shares are not quoted on any stock exchange. The fund can take the form either of a company or of an unincorporated arrangement such as a limited partnership. Variations include:

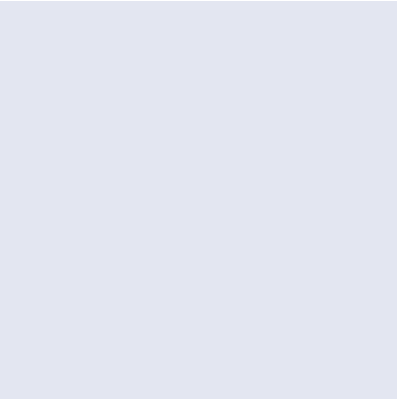
- Buyout Funds, i.e. funds whose strategy is to acquire other businesses; this may also include mezzanine debt funds which provide (generally subordinated) debt to facilitate financing buyouts, frequently alongside a right to some of the equity upside.
- Generalist funds, i.e. funds with either a stated focus of investing in all stages of private equity investment, or funds with a broad area of investment activity.

## Recapitalisation

Change in a company's capital structure. For example, a company may want to issue bonds to replace its preferred stock in order to save on taxes. Re-capitalisation can be an alternative exit strategy for venture capitalists and leveraged buyout sponsors.



# Notes



---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---

---







European Private Equity &  
Venture Capital  
Association

Minervastraat 4, B-1930 Zaventem, Belgium  
Tel: + 32 2 715 00 20 ■ Fax: + 32 2 725 07 04 ■ e-mail: [info@evca.com](mailto:info@evca.com) ■ web: [www.evca.com](http://www.evca.com)

This EVCA Research Paper is published by the European Private Equity & Venture Capital Association (EVCA).  
©Copyright EVCA March 2005