The Meaning of Intangible Assets: New Insights into External Company Succession in SMEs

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Abstract: The Commission of the European Communities (2006) estimates in its report that one third of all EU entrepreneurs will leave within the next ten years. In conjunction with the situation that (1) the majority of Europeans prefer being an employee and (2) the fact that changes in demography will reduce the pool of potential successors over the next decades, this paper argues that external (non-family) successors take on an important role and are in a position to choose the company, which best matches their expectations. A successful company succession depends on a multitude of different aspects. In the case of external succession, certainly the available funds represent a critical point. However, the assumption is that the decision to acquire a company is based on other factors. It is hypothesised that the potential external successor will be interested in those companies offering potential expansions. In view of the increasing relevance of intangible assets within the firm regarding company success, it is suggested that these assets primarily influence the external successor to go further in the succession process. Thus, it is expected that the future perspectives of the company are founded on its inherent intangibles and which in turn justify a financial investment. The aim of this paper is to explore the role of intangible assets as seen from the viewpoints of external successors. The strategy of research behind this paper is the application of a mixed methods approach which is divided into a survey approach and a case study approach (given priority). Within the quantitative stage a web-survey was used to obtain data on the relevance of intangible assets in terms of external company succession in SMEs whilst addressing members of German trade corporations and chambers of commerce. The results of the quantitative study were enhanced through qualitative interviews with ten external successors in SMEs. The data that were gathered explores the role of intangible assets during the successors' deliberations as to whether or not the company should be acquired. Intangible assets are found to be important features for external successors. Specifically five intangibles can be highlighted which are brand, partner(s), key-employees, knowledge retention, and corporate culture. The critical intangibles were summarised in a conceptual framework. The findings suggest that in the case of external succession, intangible assets have a remarkable influence on the external successor's decision-making and traditional issues in the view of company succession such as tax, legal and, financial aspects should be extended to include intangible aspects.

Keywords: SMEs, intangible assets, company succession, strategic management

1. Introduction

Intangible assets linked to external company succession in SMEs have not yet been sufficiently addressed in the academic literature. An explanation could be that company succession is primary associated with legal, financial, tax and family related issues (Amelingmeyer and Amelingmeyer, 2005). However, the increasing relevance of intangibles to all companies (Roos, Pike and Fernström, 2005) and the ever-increasing number of firms awaiting transferral (Commission of the European Communities, 2006) underlines the need for research.

The aim of this paper is to shed some light on the role of intangible assets in the context of external company succession in SMEs. The objectives are to evaluate the importance of intangible assets to external successors and to identify the intangibles currently involved in the successor's company analysis process. External successors are defined as individuals/team of individuals from outside the family who are interested in business foundation through company succession. With regard to the succession process, the emphasis is on the preparation stage in which successors seek and analyse promising companies. In this stage, the critical decision is made whether or not the company should be entered. Thus, this stage provides information about the factors that make a company attractive. The research was conducted in Germany.

This paper is structured as follows. Firstly, a brief review of the relevant literature is presented; secondly, the methodology employed is outlined. After that, the discussion of the empirical results follows. The paper concludes with a framework which is derived from the results.

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2. Literature review

2.1 Company succession in SMEs

Company succession can be defined as the simultaneous transition of property and/or management of a firm from one person to another (Ip and Jacobs, 2006). Szyperski and Nathusius (1999) specify company succession as a derivative corporate foundation compared to the original corporate foundation, in which an entirely new company is created. Based on this company succession can be viewed as equivalent to business start-up with all the opportunities and difficulties associated with it. Consequently, business foundation through company succession can be described as an alternative to become an entrepreneur, although this is often ignored (Fueglistaller, Müller and Volery, 2008).

Because of the increasing number of firms waiting to be transferred external successors are in a position to choose the company that best matches their expectations. This ‘investor market’ is confirmed by taking a glance at the online business exchange “next-change” provided by, amongst others, the German Federal Ministry of Economics and Technology, which shows a surplus of firms waiting to be transferred.

The majority of researchers agree that succession is the result of a process and not a single event (Handler, 1994). Thereby, in the academic literature several models can be found which are intended to illustrate this process (e.g. Handler (1989) in Handler, 1994; Ip and Jacobs, 2006). This study adopted the model developed by Ballarini and Keese (2006) which divides the succession process into five stages which are planning, preparation, realisation, retreat and retirement. The relevant phase for this study is the preparation stage. In this stage, promising companies are identified and analysed. Accordingly, the focus is on the decisive aspects within the company analysis process taking the successor from the preparation stage to the next stage (realisation).

Commonly, two types of succession can be distinguished which are family succession and non-family succession. Family succession describes the transfer of the company to family member(s) (Sharma et al., 2003); while in non-family situations, the company is transferred to external individual(s). These activities can be further divided into buyers from inside the company (buy-out) and buyers from outside the firm (buy-in).

Against the background presented above, company succession seems to be of considerable relevance and external succession an increasing and critical subject within this field. However, a literature review revealed that the articles dealing with the personal side of this topic are strongly focused on the other side of the business transfer process, namely the perspective of the incumbent owner (Birley, 1986; Schulte and Wille, 2006). The literature was further examined focusing on the successor. This analysis showed a primary consideration of the successor from the perspective of family succession (Scholes, Westhead and Burrows, 2008). With regard to the German-speaking countries, Schulte and Wille (2006) criticise that an empirical discussion about the topic in general is rarely found. The focus of this paper is on external (buy-in and buy-out) initiatives of individuals and/or teams.

2.2 Intangible assets

The terms “globalization” and “information technology” as key driving forces have mainly triggered dramatic changes in the structure of companies. These changes in conjunction with increased customer demands challenge companies to shift their perspective from tangible to intangible resources. In the meantime, intangible assets (IA) are considered as more important than in the 1960s, 1970s, or 1980s (Lev, 2001). These resources have always played a certain role, but now their systematic handling is seen as being an essential competitiveness factor (Wiig, 1997).

A central feature of IA is their future perspective. Edvinsson (2005) links intangibles to a new management perspective that is targeted to long-term rather short-term profit increase. This perspective is found in many German SMEs where management behaviour is based on a more long-term and ethical view rather than on satisfying financial investors´ requirements (Edvinsson and Kivikas, 2007). According to Nonaka, Toyama and Konno (2001) IA represent the type of resource a potential investor is looking for. This is confirmed by Gupta and Roos (2001, p. 297) stating that IA “are the key motivation behind mergers and acquisitions”.

The shortcomings of traditional accounting systems and consequently financial reporting with regard to intangibles have encouraged a mass of research leading to a multitude of approaches. Developments in terms of intellectual capital reporting are closely linked to individuals such as Sveiby (1997) and Edvinsson and Malone (1997) who wished to obtain a better understanding of value creation within the company. Apart from this, various national initiatives can be found focusing on intangible asset/intellectual capital reporting, e.g. Danish guidelines for Intellectual Capital Statements and German Wissensbilanz. Despite the development of a mass of different intangible asset/intellectual capital reporting approaches, only few companies apply them so far (Zambon, 2006). Another aspect to bear in mind is that the implementation of certain reporting frameworks such as the German Wissensbilanz presupposes that firms are accustomed to applying management instruments (Bornemann and Alwert, 2007). In the small firm setting it is doubtful that this condition can be fulfilled (Jennings & Beaver, 1997).

In the meantime future driven aspects are incorporated in the rating models applied by the commercial banks, as well (Everling, 2003). The inclusion of intangible assets increases the transparency of companies leading to improved ratings (Edvinsson and Kivikas, 2007). Transferred to company succession this suggests that a stronger appreciation of intangible assets may enhance a company's creditworthiness. Nonaka, Toyama and Konno (2001) regard the creation and utilization of intangibles as the core activities of a company in order to secure its continuity. This is particularly valid with regard to the current financial crisis.

Even though more and more organizations and scholars identify the prospects of taking IA into account a great problem still exists: the common language among practitioners and scholars is still missing (Marr and Chatzkel, 2004). One reason for this could be that differences arise from differing viewpoints of different interest groups or disciplines, respectively: strategy and measurement. The former is concerned with optimising the management of knowledge resources in the company in order to improve performance. The latter focuses on the setting of standards for organizational accounting in order to give stakeholders a more comprehensive picture of intangible assets in terms of traditional monetary data (Petty and Guthrie, 2000). Consequently, different definitions are in place. For the purpose of this study IA are, based on Andriessen (2004) and Lev (2001), defined as the core non-monetary resources, lacking physical substance that are able to contribute to future benefits in SMEs.

According to many authors, IA/intellectual capital (IC) can be classified into a number of distinct types of non-physical asset. These classification schemes aim to give a better understanding of what intangible assets consists of. Although with the issue of these schemes the same problem can be found as with the definition of intangibles discussed before. However, it appears that the classification of IC into human capital, structural capital and relational capital is increasingly used as a standard perspective (Edvinsson and Kivikas, 2007).

From the start of this study (end of 2005) to the time of its completion, the literature review related to the relevance of intangible aspects regarding company succession showed only little interest. Instead, specifically in Germany, a focus on legal, financial, tax and of family issues is existent (Amelingmeyer and Amelingmeyer, 2005). This was surprising because IA are regarded as key drivers of a company's value creation (Gupta and Roos, 2001), which is expected to be valid in terms of external company succession as well. This study aimed to diminish this gap by increasing our understanding of the role of intangible assets in external company succession in SMEs and thereby adding to the current knowledge in this field of research.

3. Methodology

3.1 Guiding framework

The classification scheme dividing intellectual capital into human capital, structural capital and relational capital was seen as suitable to link the research into the existing body of knowledge.

Taking this scheme as starting point, previous empirical studies were reviewed which focused on the influence of intangibles on company success. Particular attention was paid to studies involving SMEs. The rationale behind this approach was the assumption that if these intangibles do have an influence on company success they should also be of interest to a potential successor. On this basis, it was possible to identify intangible elements that may be expected to be relevant in terms of company succession. Figure 1 depicts the intangible assets employed for the construction of the guiding framework.

	Gallego & Rodríguez (2005)	Claessen (2005)	Alwert & Vorsatz (2005)	BMWA (2004)	Bontis (1998)
Human capital					
- employee	✓	✓	✓	✓	✓
- owner					
Structural capital					
- innovative capability	✓	✓	✓	✓	
- company culture		✓	✓	✓	✓
- knowledge management			✓	✓	✓
- organizational structure		✓		✓	✓
Relational Capital					
- customers	✓	✓	✓	✓	✓
- networks	✓	✓	✓	✓	✓

Figure 1: Guiding framework

Human capital is divided into employees and owner. Interestingly, none of the studies analyzed took the critical relevance of 'owner' status into consideration. Because of the owner's central position in many SMEs (Ballarini and Keese, 2006) this person cannot be neglected in terms of company succession; accordingly, this aspect was included. Structural capital includes four aspects which are innovative capabilities, company culture, knowledge management, and organizational structure. Finally, relational capital comprises customers and networks.

3.2 Research design and sampling

The research design involves the application of a mixed methods approach. As Curran and Blackburn (2001) say the use of a mix of methods helps to gain some of the advantages of both and of triangulation as well as that the weaknesses of one approach are compensated by the strength of one or more others. The mixed-method approach of this study is divided into a survey approach and a case study approach (given priority).

The quantitative research helped us to gain an overall understanding of the relevance of intangible assets in an SME environment in general. Furthermore it gave us an indication as to whether the elements of the guiding framework are seen as being of practical importance by those directly concerned. Within this a web-survey, addressing members of German trade corporations and chambers of commerce, was used. Because of the small total population (135 associations), it was decided to address the total population rather than drawing a sample. In total 51 questionnaires were received. The demographic characteristics of the participants are summarised in Table 1.

The qualitative part of the study utilized the case study approach. Multiple case studies were selected for this study since this approach has been described as being similar to replication or repetition of experiments (Yin, 2003). The data were collected through in-depth interviews with ten external successors in German SMEs. This is located in the range between 4 and 10 cases which is seen as appropriate (Eisenhardt, 1989). The data gathered explores aspects of the decision-making processes conducted by external successors. Due to a missing data pool, a particular emphasis on one industry was not possible. Thus, respondents were included coming from different industries. General characteristics of the ten cases are summarised in Table 2. The data analysis was conducted by applying a combination of inductive and deductive thematic analysis.

Table 1: Demographics of participants

Items	Absolute figures	Relative figures
Organizational affiliation		
Chambers of commerce	20	39.22%
Trade corporations	21	41.18%
Missing values	10	19.60%
Employment status		
executive position	8	19.05%
employed	32	76.19%
inhouse consultant	1	2.38%
others	1	2.28%
Valuation of SMEs		
Yes	32	71.11%
No	13	28.89%
Company size advised		
Micro		
- often	41	100%
- sometimes	./.	0%
- seldom	./.	0%
Small		
- often	18	46.15%
- sometimes	19	48.72%
- seldom	2	5.13%
Medium		
- often	./.	0%
- sometimes	8	20.51%
- seldom	31	79.49%
Location of association		
Thuringia	1	2.56%
Sachsen-Anhalt	2	5.13%
Saxony	2	5.13%
North Rhine-Westfalia	7	17.95%
Lower Saxony	4	10.26%
Mecklenburg-Western Pomerania	2	5.13%
Hesse	2	5.13%
Bremen	2	5.13%
Brandenburg	1	2.56%
Berlin	1	2.56%
Bavaria	5	12.82%
Baden-Wuerttemberg	10	25.64%

Table 2: General characteristics of cases

General information about the companies	Case 1	Case 2	Case 3	Case 4	Case 5	Case 6	Case 7	Case 8	Case 9	Case 10
Year of succession	August 2003	January 2007	December 2006	January 2003	August 1998	October 1995	March 2003	July 2006	July 2003	July 2003
Type of industry	Tempering technology	Hairdressing	Optician	Packaging	Mill	Interior extension	Galvano technology	Headgear for women	Construction	Printing
Number of employees	20	3	8	20	7	40	20	5	22	80
Location	Bavaria	Baden-Wurttemberg	Baden-Wurttemberg	Baden-Wurttemberg	Baden-Wurttemberg	Baden-Wurttemberg	Baden-Wurttemberg	Bavaria	Bavaria	Bavaria
Type of succession	Buy-in	Buy-out	Franchising	Buy-in	Buy-in	Buy-out	Buy-in	Buy-in	Buy-out	Buy-out
Management	Alone	Alone	Alone	Alone	Alone	Team	Alone	Alone	Team	Team

4. Discussion

In this section, the discussions of the empirical findings are presented. It is started with the discussion of the quantitative findings which is then followed by that of the qualitative findings.

4.1 Discussion of quantitative findings

The findings suggest that a moderate relevance of IA in the setting surveyed can be found. This refers to the relevance of intangibles within the trade associations and to their member companies in terms of IA development. It is noteworthy that the members of the chambers of commerce assessed IA slightly higher, which could be explained by the broader industry-range they are dealing with.

Although, IA are currently assessed on a moderate level, a great share of respondents expects a higher relevance of them or an equal weighting in relation to tangible assets in the future. This would imply that the shift in perspective, if at all, is still to come. Despite the current moderate assessment of IA within the associations and their members, the findings implied that with external successors intangibles take on a critical relevance in terms of decision-making. Both associations confirmed this result. The overall findings indicated that the increasing interest in IA can only be partly confirmed in this SME setting.

The pre-validation of the guiding framework signified a critical outcome of the quantitative study. The findings suggest that the guiding framework comprises of IA which are suitable for further considerations. The findings referring to individual intangible aspects and their relevance during negotiations revealed that particularly factors relating to the elements “owner”, “innovation” and “customers” seem to be important. Additionally, the findings underlined a particular relevance of the brand name. This is reasonable as an already established brand can provide the successors with benefits such as familiarity in the market which is normally not given in the case of new ventures. Due to this, this asset was integrated in the guiding framework.

As the original eight intangibles in the guiding framework were assessed moderate to high, we decided to keep all.

4.2 Discussion of qualitative findings

Intangible assets were found to be important features for external successors. The findings revealed that a multitude of intangible assets was considered and the consideration of them was given from the initial contact to the firm to the final decision. The findings referring to the critical aspect(s) that was/were responsible for having a closer look at the company in focus provided a variety of starting-points, e.g. the company was seen as model company or the firm's focus was associated with promising future prospects.

Reflecting upon individual elements the findings indicated significant differences in view of the role of the owner (incumbent) in company succession. While the academic literature highlights the great relevance of owners and their expertise and relationships (e.g. Bracci and Vagnoni, 2005), this study suggests that actual importance is primarily given in viewing them as negotiation partner. By having involved a range of sectors, most successors interviewed appeared to neglect the chance to benefit from the predecessor’s skills, expertise and business contacts. Instead, they acted more like founders of new ventures. In this context, it has to be mentioned that the companies in focus were not distressed before succession has taken place. This finding calls for the consideration if a third neutral person should be included in negotiations with the focus on lowering the role of the incumbents as negotiation partner and instead increasing it as critical asset.

One can say that the resource “employees” receives a great deal of attention, which is concurrent with earlier research (Martín de Castro & López Sáez, 2008) and the findings of the quantitative research. Particularly, key employees can be extremely important for the company in order to be successful. Thereby, the interviewees highlighted the aspects of education, experience and knowledge. Accordingly, keeping these persons is a critical goal. Drawing upon the specific importance of key employees among most successors a distinction between key employees and (ordinary) employees is recommendable as this takes into account the critical value of the formers and the measures related to keeping them.

It can be concluded that the term knowledge is primarily regarded as important when the firm’s success mainly depends on it, i.e. when specific knowledge is needed to conduct an activity. If this is not the fact, little consideration was given to it. This result is in line with Wiig (1997). Furthermore, the findings advert that knowledge is mainly associated with key employees. Thus, many successors regarded it as particularly critical to keep this/these person(s). This course of action might be of particular relevance in SMEs where knowledge is mainly in the “heads” and seldom physically stored which reduce the chance of the company to benefit from it (Wong and Aspinwall, 2004). In view of measures used to keep this knowledge, shares in the companies as well as promotions were offered, thus the focus remained on keeping it personally rather than physically. Additionally, the findings suggested that in view of company succession the concept of knowledge management is too broad. Instead, it was identified that specifically the retention of specific knowledge was of great relevance, the same was true, however on a lower level, for the storage of this knowledge. Thus, based on the study's findings it is suggested that the focus is mainly on knowledge retention comprising of retention, storage and transfer of knowledge.

Furthermore, the study proved evidence that the existence of an established brand was regarded as critical in terms of external company succession. This asset appeared to be an essential difference compared to new venture creations. However, the high relevance of the brand contradicts the small size of studies available dealing with this topic in relation to SMEs (Krake, 2005). This should change as the findings suggest that this asset can be regarded as critical element within negotiations.

The findings suggest that corporate culture is highly important for most successors. In the case of buy-outs, the assessment of the quality of culture seems to be the result of feelings built over time. Thereby positive emotions are viewed as being of crucial relevance in the decision process. In the case of buy-ins this time is normally not given, thus the successors have to base their estimations on visible elements as well as trust in one's own knowledge of human nature. Successors with many personal customer contacts valued the corporate culture very highly as they saw it as a direct link to company success. To them it is very important that the members of the company fit together.

The findings in terms of the organizational structure indicated that it was considered by some successors only. This is remarkable, since it is not immediately expected of SMEs of which it is said that their merit lies in their flexibility as a result, amongst others, of simple structures and systems (Carson et al., 1995). In terms of company succession, it seems that this is not recognised or taken for granted by some successors.

The aspect of innovative capabilities received little attention during successors´ acquisition deliberations. This finding was surprising and describes a clear contrast regarding the academic literature talking about the SMEs contributions to innovative activity (Acs, 2006).

The study confirms the relevance of customers to SMEs (Wong and Aspinwall, 2004). However, the findings also showed that successors do not regard customers as a means to new information and thus ideally to new knowledge. Instead, the successors´ emphasis during company analysis was to test whether or not a too strong dependency on few customers was in place. This approach is honourable as many SMEs are vulnerable because of this (Stokes, 2006). However, the permanent exchange with customers should be a main target as this enhances not only the possibility to develop customer-driven products/services but to quickly react to changing needs of customers, too. Moreover, the quantitative findings suggested that the associations, too, appeared to be reluctant in terms of regarding partnerships with customers as a decisive aspect in SMEs.

With regard to networks, the findings suggested that it played an inferior role in company succession, which is a logical consequence of the previous discussion. However, the interview findings also implied that the new owners make increasingly use of it. Thus, a change in perspective seems to be started confirming previous research (CEN, 2004). A similar result was obtained for innovative capabilities that seemed to be neglected in the case of external succession.

In the course of the interviews four new intangibles emerged which were partner, style, strategy and quality. The aspect "partner" gave the impression that it was more critical than the company itself. All three successors who have taken over the company in a team underlined the critical relevance of this feature. However, incumbents can do relatively little to assist in the process of partner selection. Style and strategy represented crucial factors with single successors and quality were named by two successors highlighting the relation between the product quality and company success. These intangibles seemed not to be perceived and/or underestimated by the trade associations.

5. Conclusions

From the results of the empirical studies, a framework for the role of intangibles in external succession was derived (Figure 2). The framework highlights the critical elements within the preparation stage comprising the initial contact to the company in focus and the process of company analysis. The figure illustrates that potential successors face three different initial situations to start with their intension of taking over a company: company selection, desired company, and long-standing firm member. Company selection means that a successor chooses the best company out of a range of companies because it offers e.g. promising future prospects. Desired company symbolizes a sort of model company and a successor is only interested in taking over this company. Long-standing firm member comprises the non-family members of a firm who are ready to take over. Thus, the first two options represent buy-in initiatives whereas the last one symbolizes a buy-out initiative. The right part of the figure depicts a company's composition (tangible assets, intangible assets and financial capital); representing the scope of company analysis. As the focus was on intangibles, tangible assets and financial capital are displayed in light grey; however, each company needs an appropriate mix of all elements in order to have success. As suggested by the findings, the factor "partner" - symbolizes a critical part with successors pursuing team succession - was also included and hence expands the scope of analysis. The key to understanding the intangibles relevance is as follows: assets including the aspect "partner" printed in bold (font) are of highest relevance, assets printed in italics are of high importance, and assets displayed in regular font are of moderate relevance. "Style" and "strategy" represented decisive aspects to only one successor each; consequently, they are illustrated as dotted (frame). "Quality" is illustrated in dotted as well. This is a consequence as this asset does take on a relevant position in terms of decision-making but on a minor level compared to the other intangibles displayed. Finally, the black arrows illustrate interconnections with another intangible asset. The figure also highlights that networks and innovative capabilities were not included because of their minor importance in this research.

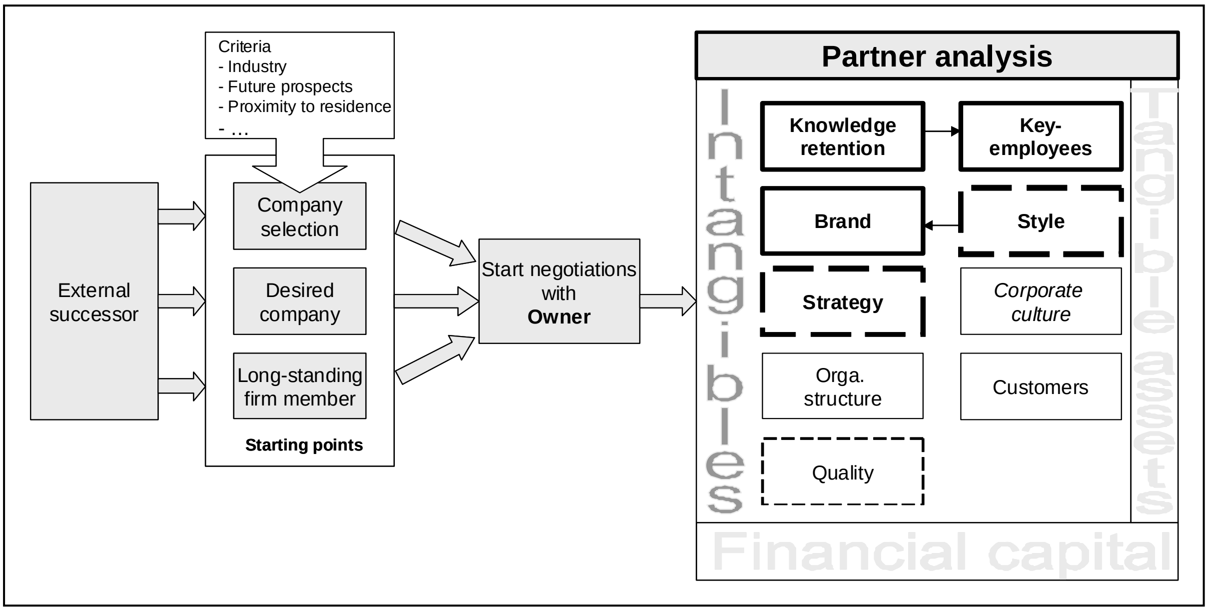

Figure 2: A framework for the role of intangibles in external succession in SMEs

This framework provides a new perspective on external company succession in SMEs as it underlines the intangible assets making a company attractive to external successors. Consequently, the framework provides insights into the process that occurs between company foundation decision and business transfer. In practical terms, the framework guides the parties involved in their activities during the preparation stage.

From this study it can be concluded that in the case of external succession, intangible assets have a remarkable influence on the external successor's decision-making and therefore traditional issues in the view of company succession such as tax, legal and, financial aspects should be extended to include intangible aspects. This is highly important in view of the increasing number of SMEs waiting to be transferred and thereby providing information on what makes a company attractive to external successors and thus allows the derivations of suitable measures to adequately deal with this topic. Furthermore, with this study an attempt has been started to get corporate foundation through company succession out of its shadowy existence.

This study also has limitations. The situation that the qualitative study was prioritized implied that only analytical generalizations (Yin, 2003) are possible. Thus, the qualitative study of the ten German successors does not allow inferences to be made as to whether the results would also apply to successors in other countries. This can also be transferred to the survey; the small number of participants can only provide an incomplete perspective of the SME surroundings. Accordingly, there are some avenues for future research.

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