THE INFLUENCE OF THE BANKING CRISIS ON THE LENDING BEHAVIOUR OF BANKS TOWARDS FAMILY BUSINESS SUCCESSION.

MSc in Business Administration

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Abstract

The topic family business succession has received a great amount of attention from academic researchers and business practitioners. However most of the research has focused on studying the personal factors, succession process factors, and firm factors that influence family business succession. There is limited information available about the way family business succession is financed and how the crisis of 2008 affected this financing process.

This research builds on theories discussed by academics to study the financial decision making process of family firms. Thereafter, the influence of the banking crisis on the lending behaviour of banks toward family business succession is studied. This is done by administering questionnaires and in-depth interviews among three financial service providers and four family firms.

The results of the interviews indicate that since 2010 almost all succession financing is done by the use of the company succession facility where a large sum of the firm value can be donated to the children tax free. Before the banking crisis of 2008 the past historical results and a small forecast were enough to get financing from a bank. Nowadays a well-founded business plan is needed with corresponding information about the financing request, the long-term results, and the future prospects of the entrepreneur. Furthermore, banks expect more financial input from the selling and buying party which is often 10% of the financing request. Due to the crisis companies are submitted faster to special management within a bank when their results are deteriorating or if they ask for deferment of payment. Another result of the banking crisis is that there are less debt providers on the market. There are so many rules and regulations that the compliance is so expensive that new banks cannot rise and small banks cannot exist.

Family firms did not search for other forms of financing because of trust issues towards banks but their image of bank employees is severely damaged. The amount of financing requests did decrease because of the crisis. Research has shown that the financing of succession and other forms of investments is changing from strictly bank funding to a combination of financing parties like the bank, the owner, the state with guaranteed credit, leasing companies, and private equity firms. This means that the part the bank is playing in financing is becoming smaller and in its place it will take the form of a consultancy firm which brings together all the financing parties.

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1. Introduction

After the crisis hit the bottom, it became clear that the credit loans decreased enormously. The volume of lending by Dutch banks to SMEs showed a sharp decline after 2008. In this thesis, the effect of the banking crisis on family firms is studied. In particular research is done on the effect of the crisis on succession financing. The results of this thesis may be useful for owners of family firms that are searching for external financing for succession. The outcome of this thesis may be a reason to look for other forms of financing or to speed up the decision process. Besides that, the outcome of this analysis can be useful for Dutch banks on the field of financing policy toward family firms, especially the firms that need financing for succession related expenditures.

1.1 Problem definition

The topic, family business succession, has received a great amount of attention from academic researchers and business practitioners. However most of the research has focused on studying the personal factors, succession process factors, and firm factors that influence family business succession (Koropp, Grichnik, & Gygax, 2013). There is limited information available about the way family business succession is financed and how the crisis of 2008 affected this financing process. Most studies related to business succession financing focus on the impact on the capital structures of the companies after succession and the difference in capital structure between founder companies and descendant-controlled companies (Koropp et al., 2013). The banking crisis started in September 2008, due to this crisis the lending to companies declined across all types of loans such as loans for investments, buyouts, takeovers and succession (Ivashina & Scharfstein, 2010). This reduction in loans of banks to companies is, besides the decrease in financing requests, partly due to the fact that banks reduced their lending (Ivashina & Scharfstein, 2010). This thesis focuses on the actual financing of the succession itself and the effect of the banking crisis on the bank lending behaviour towards family firms.

In this thesis the following central research question is studied:

In what way did banking crisis influence the lending behaviour of banks towards family business succession?

1.2 Goal of this research

The goal of this research is to find out to what extent the banking crisis of 2008 influenced the lending behaviour of banks towards family business succession. I expect that the lending by banks decreased due to the crisis but also the need for financing of firms decreased, because organizations are less eager to invest in an uncertain economic environment. Furthermore, I want to discover if family firms search for new suppliers of credit if their principal banker refuses to provide a loan.

The academic literature on family business succession is mainly focussed on studying the personal factors, succession process factors and firm factors that influences family business succession. The literature on succession financing focuses mainly on the impact on the capital structures of the companies after succession and the difference in capital structure between founder companies and descendant-controlled companies.

This study adds to the existing literature by providing an insight on the drivers of the choice in type of financing and if the banking crisis affected the external succession financing. By incorporating data from interviews with financial service providers and successors in this study, it is possible to get some more in-depth knowledge about succession financing and the factors that influence financial decision making.

This study provides managers of family firms with an understanding of the factors that influence their decision making with regard to succession financing. Family firm owners and successors may use the provided knowledge in their decision making process regarding succession financing. The results of this study may also provide some new insights with regard to the multiple financing possibilities of succession.

1.3 Questions based on the research goal and problem statement

In order to come to a complete and well-founded answer on the research question, this question is divided into four sub-questions. These sub-questions and their relevance to the study at hand are mentioned below.

1. *What type of financing do family firm owners prefer?*

This sub-question is relevant to this research because it is needed to get a better understanding of how family businesses are commonly financed and what the reasons are for these capital structure choices before we can form an answer on the research question. According to the literature, in family business succession it is often a family member that acts as the successor (Van der Eijk, Flören, & Jansen, 2004). Van der Eijk et al. (2004) states that smaller companies are likely to be faced with low succession expenses and thus have smaller needs for external financing. In this research we focus on family firms with minimum sales of two million euros and a minimum of ten employees. In these types of family firms the successor needs to come up with a large amount of money in order to be able to finance the succession process. These amounts of money usually need to be borrowed internally or externally.

2. *Do family firms prefer debt over external equity financing?*

The use of debt for financing has tax benefits compared to financing with equity financing. According to the literature, family firms are known to develop financial strategies to reduce their tax burden (Modigliani & Miller, 1958). Furthermore, owners of family firms usually invest most of their wealth into the business which leads to the fact that there is no equity to finance the succession process internally (Schmid, 2013). Theory also states that family firm owners rather choose debt financing than external equity financing (Green & Hollifield, 2003).

3. *What are the major factors influencing the capital structure of family firms?*

There are a lot of personal factors that influence the capital structure of the family business. This sub-question is of importance because the banking crisis of 2008 can have a large impact on the capital structure choices of family firms. According to the literature, family firm owners are large investors in their own company which leads to the fact that financial risks can harm the family (Schmid, 2013). Therefore, family firm owners are usually highly risk avoidant (Schmid, 2013). Besides that control is very important for family firm owners because of their long-term commitment to the firm, the reputation of the firm and thus the family, and the regard of the family firm as a legacy for future generations (Schmid, 2013).

4. *What does the financing policy towards family firms look like, and was this different before the crisis of 2008?*

According to the literature, the banking crisis of 2008 led to the decrease in lending behaviour of banks with regard to all types of financing (Ivashina & Scharfstein, 2010). In order to answer the research question we need to know what changed between the situation before and after the crisis of 2008, in the financing policy of banks toward family firm succession. Furthermore, the actual impact on succession financing is relevant to, for example, discover if family firms search for new suppliers of credit if their principal banker refuses to provide a loan.

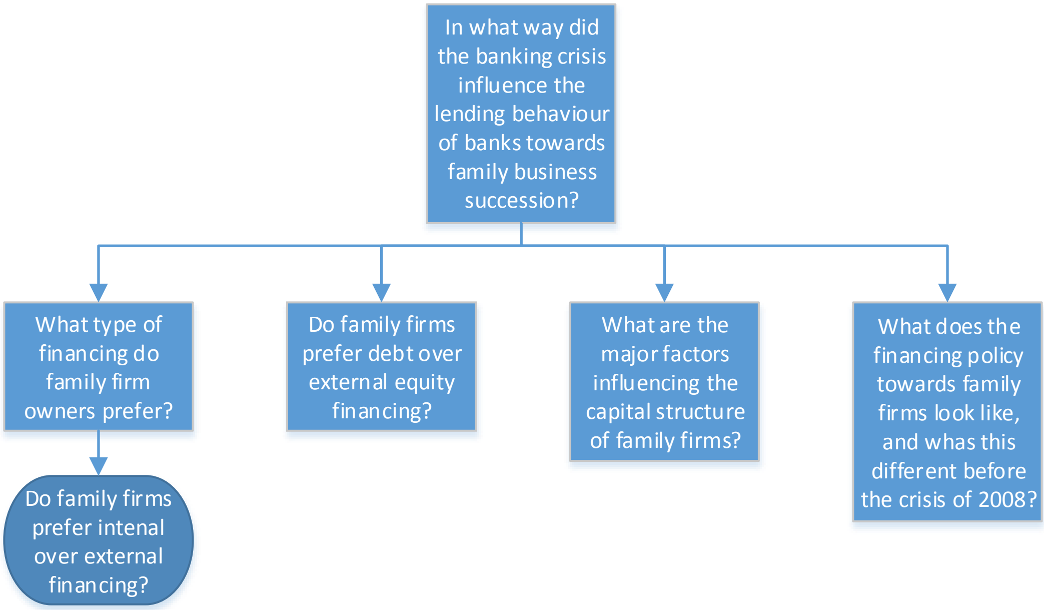

Figure 1.1: Correlation between the research question and sub-questions

1.4 Research methodology

For the writing of this thesis, information is gathered from multiple databases. The thesis includes information from scientific articles from different journals and databases provided by the University of Twente as main source of information. This paragraph explains how the sub-questions will be researched and answered.

1. *What type of financing do family firm owners prefer?*

We first need to discover the factors that influence the decision making process of family firm owners to use internal or external financing for business succession. This sub-question will be answered by collecting data from previous studies. Previous research on internal and external financing and family firms will be analysed. This theory will be re-tested in practice by conducting a questionnaire and in-depth interviews among four family firm owners and three financial service providers.

2. *Do family firms prefer debt over external equity financing?*

We first need to find the factors that influence managers' decision making process to use debt over external equity financing for family business succession. This sub-question will also be answered by collecting data from previous studies. Previous research on debt and external equity financing and family firms will be analysed. This theory will be re-tested in practice by conducting a questionnaire and in-depth interviews among four family firm owners and three financial service providers.

3. *What are the major factors influencing the capital structure of family firms?*

We first need to discover the factors that influence managers' decision making process with regard to capital structure choices. This sub-question will also be answered by collecting data from previous studies. Previous research on capital structure and family firms will be analysed. This theory will be re-tested in practice by conducting a questionnaire and in-depth interviews among four family firm owners and three financial service providers.

4. *What does the financing policy towards family firms look like, and was this different before the crisis of 2008?*

In the questionnaire and in-depth interviews with four family firm owners and three financial service providers, the current financing policy of banks will be discussed. Furthermore, the question will be asked if the respondents see any difference between the financing policy before and after the crisis. If so, the respondent will be asked to mention the specific changes.

In order to answer all the sub-questions it is necessary to clarify the unit of analysis. The subjects for this analysis are family business owners who completed the succession process. The literature states that smaller companies are likely to be faced with low succession expenses and thus have smaller needs for external financing (Van der Eijk et al., 2004). Therefore only SMEs with minimum sales of two million euro and ten or more employees will be included in the sample. Furthermore, financial service providers may be able to give insights in the financing choices of family firm owners. In order to test the theory with practice one interview per family firm and financial service provider will be conducted. Four family firms and three financial service providers will be chosen which leads to data of seven interviews.

1.4.1 Survey Research: questionnaire and in-depth interviews

The survey research strategy is a type of qualitative research (Babbie, 2012). The present study focuses on the effect of the banking crisis on family business succession financing, thus the study is exploratory.

According to Babbie (2012) survey research is the best method to collect data about a population that is too large to observe directly. The study in this paper uses questionnaires and interviews to collect survey data. There are a few advantages to administering an interview instead of a questionnaire that is handled by the respondent. Interview surveys usually have higher response rates than questionnaires (Babbie, 2012). The presence of the interviewer in the survey leads to an increase in the quality of the answers on the questions asked. The interviewer can clarify questions, probe for answers, and observe the respondent(s) (Babbie, 2012). Therefore, the in-depth interviews with the family firms and financial service providers will be conducted after the questionnaires are filled in. Furthermore, the interviewer has the ability to ask many questions and by that, analyse if the findings from theory correspond with practice.

There are also several disadvantages to administering an interview. According to Babbie (2012) the standardization of the questions in surveys can jeopardise the research because the researcher may miss what is really important to the respondents. In this way surveys can become apparent and do not cover the charge of the research (Babbie, 2012). A remedy for the problem of standardization is to perform in-depth analysis of the survey research results (Babbie, 2012). By the use of questionnaires in survey research, it is hard for the researcher to understand the context of the situation in which respondents are thinking and acting (Babbie, 2012). By administering the questionnaire and thereafter conducting an in-debt interview, this problem can be eliminated. Surveys usually require a strict research design in order to come to comparable answers between questionnaires, in this way it is difficult to discover new variables that can be of importance to the research (Babbie, 2012). By conducting an interview survey the researcher can become aware of an important new variable and include it in the study.

1.4.2 Case selection

In order to answer sub-question one, two, three and four it is necessary to clarify the unit of analysis. The subjects for this analysis are financial service providers and family businesses who completed the succession process. The literature states that smaller companies are likely to be faced with low succession expenses and thus have smaller needs for external financing. Therefore I use only SME's with minimum sales of two million euro and ten or more employees.

1.4.3 Data collection

The data collected for this paper is retrieved from different academic journals and the book 'Financiering van de bedrijfsoverdracht binnen familiebedrijven' written by Van der Eijk et al. (2004). As foundation of the theory in this research I used the book of Van der Eijk et al. (2004). The reason for this is that the writer has used a structured and complete set of theories on family firms, the succession of family firms, and the financing of family firms. The following journals were found through SCImago Journal & Country Rank (SJR) (2007); Journal of Financial Economics, American Economic Review, Small Business Economics, The Journal of Finance, Journal of Banking and Finance, Journal of Business Venturing. Thus Economic journals were used who are listed in the SJR (SCImago, 2007). Three of the six journals rank in the top ten of the SJR Journal & Country Rank database. Articles from the previous mentioned journals were used to elaborate upon the theory of Van der Eijk et al. (2004). Not all relevant journals and articles were used because time was limited.

1.4.4 Reliability

A measurement method is reliable when it yields the same results after multiple observations. To ensure the reliability in this study, questions in the questionnaire are standardized. This way the researcher can make more certain observations which increases the reliability of the study (Babbie, 2012). Furthermore, the reliability of the respondent can be increased by carefully formulating the questions in the interview (Babbie, 2012). Another reliability problem is "bias". The researcher is the source of data which means that the interpretation of answers given in the interview can be coloured by the researcher (Babbie, 2012). Several techniques will be used to enhance the reliability of the study, these techniques will be discussed below.

Test-Retest Method

By first administering the questionnaire and thereafter the in-depth interviews, while the results stay the same, the reliability of the research method is enhanced. If the answers differ, the research method is not reliable enough for the study (Babbie, 2012).

1.4.5 Validity

A measurement method is valid when it is measuring exactly what the researcher has intended to measure. Survey research is often weak on validity because of the artificiality problem (Babbie, 2012). The artificiality problem means that it may be impossible to perform the study by the use of a questionnaire besides that, the studying of the topic may affect the outcome of the study. In this study, the validity is not compromised by the artificiality problem because the respondent should answer questions about events and facts from the past. What is of utmost importance is that the researcher should not interfere with the answers given on the questions asked and outcome of the research.

1.5 Thesis structure

In chapter one the problem statement, goal of the research and the methodology of the research were discussed. Chapter two contains a literature review in which succession financing is further defined. The second chapter also addresses sub-question one: *What type of financing do family firm owners prefer?* In order to answer this question, internal, external, and a combination of internal and external financing are discussed. The third chapter focuses on sub-question two: *Do family firms prefer debt over external equity financing?* The factors that influence the capital structure decision of family firms are discussed in chapter four where sub-question three: W*hat are the major factors influencing the capital structure of family firms?* Building on several theories and related empirical evidence the influencing factors are discussed. Furthermore, the changes in the financing policy after the banking crisis are discussed in chapter five where sub-question four is: *What does the financing policy towards family firms look like, and was this different before the crisis of 2008?* Chapter six provides an analysis of the outcomes of the interviews. The seventh chapter provides conclusions and a discussion on the limitations of this study. In addition, recommendations regarding future research are provided.

2. Financing types and family firms

In this chapter the sub-question: *What type of financing do family firm owners prefer?* will be studied. Previous research has shown that the financing types in family firms can be divided in internal and external financing. In this paragraph the above mentioned sub-question and financing possibilities will be discussed with reference to the theory of Van der Eijk et al. (2004). This book is a basis for answering the question, because the author has used a complete set of theories on inter alia, internal and external financing. According to Van der Eijk et al. (2004) the owner of the family business is generally prepared to co-finance the succession process. It is difficult to obtain succession financing without the co-financing of the owner because of the solvency requirement that the banks demand.

Overall, succession can be financed in one of the following manners:

- Internal financing
- External financing
- A combination of internal and external financing

Because complete internal financing occurs frequently in succession financing, this financing type will be discussed first.

2.1 Internal financing

Internal financing of succession can be funded by the contribution from the successor, from the owner, and from other family members. These three financing types will be discussed respectively.

Contribution from the successor

In general the financing requirements of succession involve such large amounts of money that the equity of the successor is insufficient to fund the whole succession process (Van der Eijk et al., 2004). However, there are cases in which the owner has transferred large amounts of assets to the successor over the years (Van der Eijk et al., 2004). But even in these cases the successor has to borrow sizeable amounts of money to finance succession-related expenditures. In most cases the successor invests his own equity capital in the succession process, but in some cases the successor chooses debt over equity because of the tax benefit (Van der Eijk et al., 2004).

Contribution from the previous owner

The transferring of the company to a family member, in most cases the child(ren) of the owner can be partly financed by the owner (Van der Eijk et al., 2004). This is among others due to the fact that the successor does not have enough equity to finance the succession-related expenditures (Van der Eijk et al., 2004). Variables that influence the investment amount of the owner are: The extent to which the owners pension depends on the selling price; the amount that the owner wants to invest; the equal treatment of the children of the owner; the number of children of the owner; the extent to which the other children allow the financing of the succession-related expenditures by the owner (Van der Eijk et al., 2004).

When the owner is able to finance the succession-expenses fully or partly, there are some possibilities that will be mentioned below:

1. financing by borrowing money from private equity or from the holding;

The back borrowing of the money spend on succession-related expenditures by the successor in combination with a holding company structure is a common method (Van der Eijk et al., 2004). But there are some disadvantages: It can be hard for the owner to take distance from the family firm, not only financially but also in leadership; the financial risk, there is a possibility to lose all the money invested; the return is too low in comparison with the risk of the investment; the invested money is not direct accessible for the investor (Van der Eijk et al., 2004).

2. gradual transfer of shares;

The gradual transfer of shares is the arrangement between the owner and the successor to buy the shares from the owner over time (Van der Eijk et al., 2004). In this way the successor can save money to finance the succession-related expenditures (Van der Eijk et al., 2004). The disadvantage of this approach is that every time the successor buys shares, the shares that stay in possession of the owner have to be re-valued (Van der Eijk et al., 2004). The revaluation can result in the adjustment of the share price (Van der Eijk et al., 2004). This possible fluctuation can be of impact on the total amount of the transfer expenses and thus on the financing requirements (Van der Eijk et al., 2004).

3. Payment in instalments.

The payment in instalments out of the profit is a fiscal method where the family firm (the assets and liabilities) is sold by the operating company (Van der Eijk et al., 2004). The sale price of the company is known and fixed (Van der Eijk et al., 2004). Besides amortization of the sale price, interest has to be paid over the remaining amount (Van der Eijk et al., 2004). This interest is paid in the form of cumulative preferred dividend (Van der Eijk et al., 2004). If the owner and the successor agree on payment in instalments the succession-related expenditures can fluctuate in sale price of the company and/or the amount to be financed (Van der Eijk et al., 2004). The construction has in this case more the structure of a gradual transfer of shares, especially when the payable amount depends on the performance of the company (Van der Eijk et al., 2004). This fluctuation is not known in advance which makes the loan conditions not easy to set (Van der Eijk et al., 2004).

Contribution from other family member(s)

When more than one family member decides to take over the family firm, these family members can become shareholders of the firm (Van der Eijk et al., 2004). In this case it is possible to issue new shares and thus increase the equity capital of the family firm (Van der Eijk et al., 2004).

When the shares of the company stay in the hands of one person, other family members can lend money to the family firm in order to finance the succession-related expenditures (Van der Eijk et al., 2004).

2.2 External financing

Succession financing may cause external financial demands because the owner and their families usually invest most of their wealth into the business and family firms do not possess vast internal financing capabilities (Koropp et al., 2013). The need for succession related financing arises because the transfer of ownership incurs significant transaction cost (Van der Eijk et al., 2004). The ownership transfer usually involves tax payments, such as inheritance and income taxes, compensatory payments to other family members or heirs, and/or payments to the predecessor, such as purchase prices for ownership shares (Van der Eijk et al., 2004).

The top management of a family prefers internal over external financing because it imposes fewer restrictions on the management team (Koropp et al., 2013). The future succession financing decision may be subject to obstacles that are outside of the owners sphere of influence (Koropp et al., 2013). For example, low firm profitability or high firm growth will limit the family firms self-financing capability (Koropp et al., 2013). In these cases, the owner would likely be forced to utilize external financing (Koropp et al., 2013). Family firm owners usually hold very favourable attitudes toward internal financial sources such as retained profits or family wealth (Koropp et al., 2013). However regarding external financing, owners commonly possess more positive attitudes toward debt financing than toward external equity financing (Koropp et al., 2013).

The reluctance of family firms to use external financing is partly due to ingrained, long-term prejudices and norms maintained by the family (Van der Eijk et al., 2004). A high need for family control is the major cause of an owners aversion to external financing (Van der Eijk et al., 2004). The lack of communication between the family firm and external financiers like banks, and the lack of experience, and knowledge of one another are also reasons for family firms not to engage in external debt financing (Van der Eijk et al., 2004). Furthermore, the lack of appropriate financial statements; the low track record of the successor due to limited work experience; and the attitude of the external financier towards family firms succession related to the risk of the investment, are also reasons for family firms not to engage in external debt financing (Van der Eijk et al., 2004).

The use of debt financing for succession-related expenditures may affect family control because debt suppliers frequently require control and monitoring rights (Van der Eijk et al., 2004). In family firms with a strong desire to maintain family control, owners will prefer internal rather than external financing for succession-related expenditures (Van der Eijk et al., 2004). If owners already experienced a succession process, they may be more likely to anticipate succession expenditures (Van der Eijk et al., 2004). Additionally they may be more likely to engage in financial planning activities, both of which reduce the need for external financing during the succession process (Van der Eijk et al., 2004). When owners engage in planning early, they can pursue activities that will reduce the need for external financing (Van der Eijk et al., 2004). However, family firms are likely to need outside financing as a part of the succession process (Van der Eijk et al., 2004). Deliberate succession planning may enable the owner to foresee the need for external financing during succession (Van der Eijk et al., 2004).

In order for the external financer to evaluate the need for financing, the operating ratio's that lead from the financial statements will be used (Van der Eijk et al., 2004). These ratios indicate how much money the company can borrow (Van der Eijk et al., 2004). A common method used besides the ratio analysis, is the liquidity analysis (Van der Eijk et al., 2004). The liquidity of a company is its ability to turn short-term assets into cash in order to cover the short-term debt (Van der Eijk et al., 2004). Liquidity ratios are often used by external financiers to determine whether or not the company is likely to go bankrupt (Van der Eijk et al., 2004). With the liquidity analysis it can become clear what the financing need of the company is (Van der Eijk et al., 2004).

External financers have a wide variety of products that can be used to finance the succession-related expenditures (Van der Eijk et al., 2004). The most common internal methods of succession financing are, subordinated debt, and participation of a financing company (Van der Eijk et al., 2004). The most common external methods of succession financing are a current account, short-term debt, long-term debt, mortgage and unsecured credit (Van der Eijk et al., 2004). Whether the unsecured credit will be provided depends on the compensation banks demand (Van der Eijk et al., 2004). The amount of interest depends on the future expectations with regards to the firm and the manager; the profitability; the solvency; and the securities of the firm (Van der Eijk et al., 2004).

The profitability of the firm and the trust in the manager are variables that cannot be influenced at the time of the financing (Van der Eijk et al., 2004). However the solvency and the securities of the firm can vary during the financing process (Van der Eijk et al., 2004). The change in the previous mentioned variables can result in changes in the height and conditions in the external financing amount (Van der Eijk et al., 2004). The solvency and the securities can be influenced by the following factors: additional participation in the equity of the internal or external party; guarantee provided by the state; guarantee provided by the owner; guarantee provided by the successor's private equity; the subordination of existing loans; the use of a subordinated loan (Van der Eijk et al., 2004).

The experience of owners of family firms is that in case of external financing, the financer regularly asks for more securities than necessary (Van der Eijk et al., 2004). Family firms experience the formation of the external financing as opaque (Van der Eijk et al., 2004). When external financing is not successful the type of credit can be adjusted by for example, changing the bank loan into a convertible bond (Van der Eijk et al., 2004). The risk of the bank to lose part of the control in the firm can also form a motivation for the bank (Van der Eijk et al., 2004). Banks will try to control the firm in case of wrongful management, in these cases the bank can intervene which gives them more certainty (Van der Eijk et al., 2004).

In most cases of succession the owner of the family firm will finance (part) of the succession-related expenditures because the family firm usually represents a significant value that the successor alone is not able to finance (Van der Eijk et al., 2004). External financers are generally not willing to finance all the succession-related expenditures (Van der Eijk et al., 2004). To reduce the risk banks will suggest financing forms where the government will take responsibility for part of the risk in a so called guaranteed credit (Van der Eijk et al., 2004). The disadvantage of this credit is that the risk for the bank must be at least equal to the guaranteed credit as guaranteed capital (Van der Eijk et al., 2004). This is also called mezzanine financing (Van der Eijk et al., 2004). The risk for the owner is higher than that for the bank which generally leads to a lower interest rate with respect to the bank loan (Van der Eijk et al., 2004).

This figure is established by summarizing the results of the theory from chapter two.

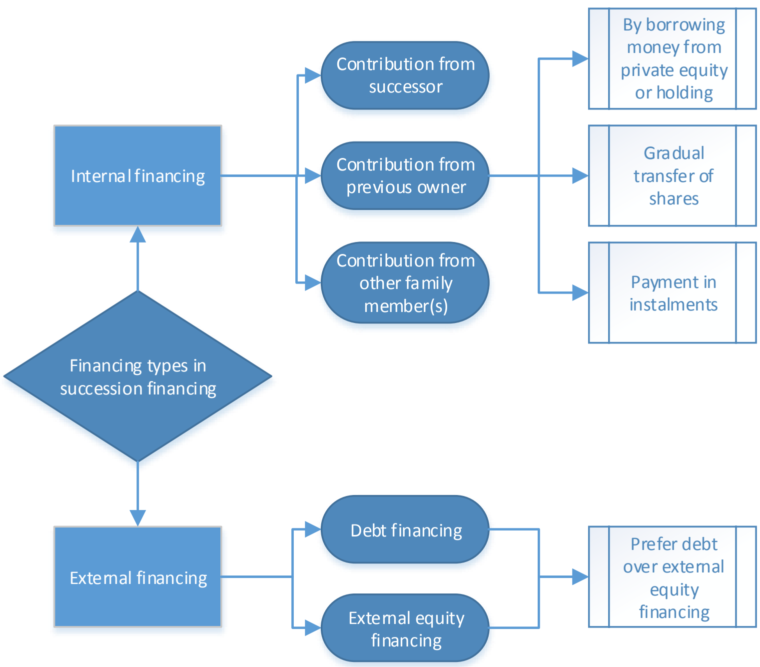

Figure 2.1: Financing types in family firm succession.

3. Debt and equity financing in family firms

As is mentioned in the previous chapter, external financing is commonly used in the succession financing process. In this chapter the question: *Do family firms prefer debt over external equity financing?* will be studied.

Debt financing is when a business receives money for capital expenditures or working capital by selling bonds, bills, or notes to individual or/and institutional investors (Leach & Melicher, 2011). These investors receive interest on the total amount of debt and the promise that this debt will eventually be repaid (Leach & Melicher, 2011). The other way of raising capital is by using external equity financing which will take place by issuing shares of stock in a public offering (Leach & Melicher, 2011). Debt comes in the form of bills, bond issues or long-term notes payable, while equity is classified as angel investors, venture capital, leasing company, private equity firm etc. (Leach & Melicher, 2011).

A high aversion to control risks is found to motivate family firm owners to use less debt and to rely more on retained earnings (Schmid, 2013). A family firm owner who possesses financial knowledge and skills regarding available financial resources, financial contracting, and the functioning of financial resources and capital markets is better able to realize the value of external financial resources for the business and to overcome ingrained prejudices against debt (Schmid, 2013). Owners of family firms that have favourable prior experiences with debt financing are found to be less cautious about raising debt, whereas owners with negative prior experiences are less likely to engage in new debt financing (Koropp et al., 2013). Consequently, owners who have had positive experiences with debt suppliers in the past will likely utilize debt for financing succession-related expenditures (Koropp et al., 2013). Successors are less inclined and less willing to bear business risks compared to their parents which may also lead to a decreased utilization of debt (Koropp et al., 2013).

Equity financing is important in the financing of firm growth because there is a limited amount of money that can be debt financed because of the solvency requirements the banks demand (Wu, Chua, & Chrisman, 2007). Wu et al. (2007) state that family involvement in controlling ownership or also controlling ownership and management, are related to the use of less equity financing and more debt financing. According to (Wu et al., 2007) firms with family controlling ownership tend to take higher financial risk, this means that family business owners tend to adopt a highly levered capital structure because of their desire to maintain control.

According to (Leach & Melicher, 2011) many owners of, not only family firms but firms in general, don't like the constrains that comes with the use of debt, like the legal actions that comes with missing a payment and the regular interest costs (Leach & Melicher, 2011). There are also disadvantages that come with the use of equity financing like the ownership dilution (Leach & Melicher, 2011). Convertible and equity financing in most cases comes with high expected returns while on the other hand debt has a lower expected return and has tax benefits (Leach & Melicher, 2011). If the owner and the successor succeed in finding debt financing for the succession process and tolerate the non-cooperative approach in this type of financing, the owner retains more control over the firm (Leach & Melicher, 2011).

The financing of family firms involve a trade-off between the pursuit of growth and the maintaining of control (Wu et al., 2007). Using a highly levered capital structure or limiting growth, allows the family firm to maintain control and pursue complex objectives (Wu et al., 2007). Even when equity financing is used, family firms prefer private equity over public equity (Wu et al., 2007). This could help mitigate some of the agency conflicts between minority and majority shareholders and avoid what family members might consider excessive monitoring by public equity suppliers (Wu et al., 2007).

Because debt is preferred to equity financing in family firms, succession planning may increase the owners intention to use debt financing for succession-expenditures (Van der Eijk et al., 2004). Succession planning may include tax planning, because it is widely accepted that debt carries tax benefits, and family firms are known to develop financial strategies to reduce their tax burden (Van der Eijk et al., 2004).

According to Green and Hollifield (2003) the personal-tax advantage to equity is not sufficient to completely offset the tax advantages of debt, where all payments to debt are fully deductible. But the tax advantages of equity are enough to change capital structure choices when tax shields are uncertain, redundant or for plausible levels of bankruptcy costs (Green & Hollifield, 2003).

Debt financing is a way to finance investments to achieve growth of the company without waiting for the firm's earnings first (Wu et al., 2007). Debt financing is often used in companies with an aggressive growth strategy, provided that the interest rate is low (Wu et al., 2007). Another advantage of debt financing is that you don't have to pay off your debt immediately but you can pay in installments over a period of time (Leach & Melicher, 2011). Compared to equity financing, in debt financing the owner of the company doesn't lose any ownership or control of the firm (Leach & Melicher, 2011). Furthermore, the use of debt comes with tax advantages (Green & Hollifield, 2003).

One of the disadvantages of debt financing is that interest has to be paid over the amount of money borrowed (Leach & Melicher, 2011). If the company misses payments, it faces legal actions from the financial institution like property and assets repossession (Leach & Melicher, 2011). Furthermore, the future profits of the company cannot only be used to invest in the firm or to pay the owners, it must also be used to pay the financial institutions (Wu et al., 2007). A highly levered capital structure can limit future cash flows and counteract growth (Wu et al., 2007).

The advantage of equity financing is that the financing doesn't need to be repaid and the risks and liabilities are shared with the new investors (Wu et al., 2007). The future cash flow and profits can be used to further growth of the company and to pay the shareholders (Wu et al., 2007). Furthermore, the low debt-to-equity ratio is beneficial to make a request for funding in the future (Leach & Melicher, 2011).

The disadvantage of equity financing is that you have to give up partial ownership to the investors and with that, decision-making authority (Wu et al., 2007). Besides that, a portion of the future earnings goes to the equity investor (Wu et al., 2007). The amount of dividends paid will eventually exceed the amount of interest paid in the case of debt financing (Wu et al., 2007).

This table is established by summarizing the results of the theory from chapter three.

	Advantages	***Disadvantages***
Debt financing	Fast growth No immediate payment of the financing Ownership and control stays with the owner Tax advantages	Interest payments Missing payments → legal actions Future cash flow and profits partly to financial institution Highly levered firm → limit future cash flow and counteract growth
Equity financing	No need to repay the financing Risks and liabilities are shared with the new investors Future cash flow and profit can be used for investments etc. Low debt-to-equity ratio	Give up partial ownership and control Portion of future earnings to equity investor Amount of dividends paid will eventually exceed the interest payment in debt financing

Figure 3.1: Advantages and disadvantages of debt and equity in succession financing.

4. Factors influencing the capital structure of family businesses

As mentioned in the previous chapter, debt financing is preferred instead of equity financing because of inter alia the tax advantages and control considerations. There are theories that try to explain the capital structure choices of a firm. There are also personal factors that influence the capital structure of a family business which will be discussed in this chapter.

In this chapter the question: W*hat are the major factors influencing the capital structure of family firms?* will be studied. The capital structure of an organization is how a company finances its growth and operations by using external financing, like common equity, preferred equity, short-term debt and/or long-term debt (Leach & Melicher, 2011).

Modigliani and Miller (1958) have laid the foundation for the study of capital structure theory with their capital structure irrelevance principle. The Modigliani & Miller (M & M) theory states that in an efficient market, where there are no taxes, bankruptcy costs, agency costs, and asymmetric information, the value of a levered firm is the same as the value of an unlevered firm, this is also called proposition one (Modigliani & Miller, 1958). Proposition two of the M & M theory states that an increase in the debt-to-equity ratio leads to a higher required return on equity because of the bankruptcy costs that come with the risk of debt (Modigliani & Miller, 1958). This proposition is true in a market with no transaction costs, and if the cost of debt is the same for individuals and corporations (Modigliani & Miller, 1958).

In a market with taxes and tax advantages, Modigliani and Miller (1958) state that firms make an assessment of debt advantages against the cost of financial distress in order to optimize the market value of the firm. This theory is called the trade-off theory which incorporates the tax savings as debt advantages (Modigliani & Miller, 1958).

According to the trade-off theory firm value can be maximized when the debt advantages and costs are weight up against each other with the optimal capital structure (Shyam-Sunder & Myers, 1999).

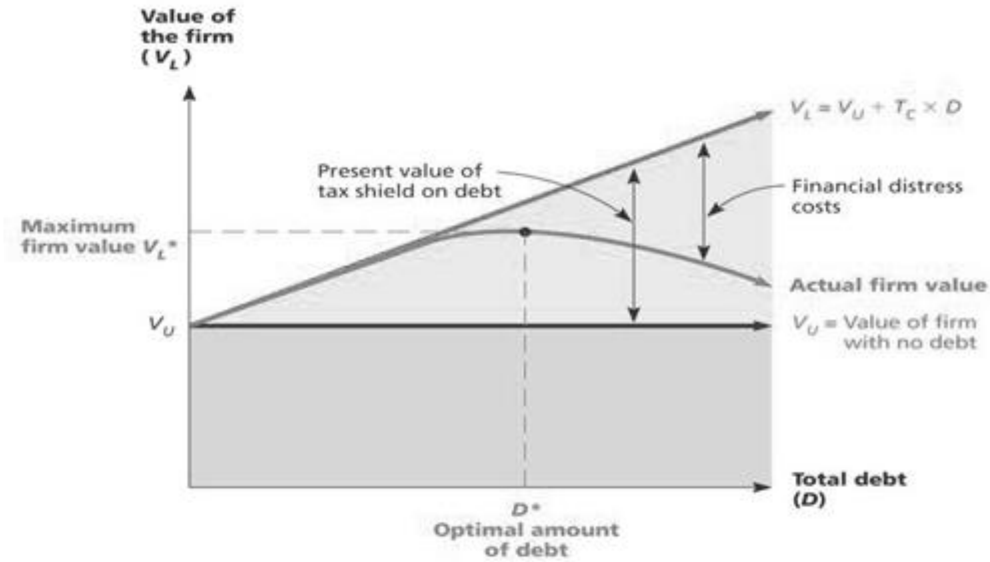

Figure 4.1: The trade-off theory of optimal capital structure when there is a balance between tax advantages and costs of financial distress. Source: Hillier, Ross, Westerfield, Jaffe, and Jordan (2010)

The optimal capital structure of a firm can also be found by using the weighted average cost of capital (WACC) method. The WACC is calculated by the rate of return that equity and debt providers demand on their investment and the market value of equity and debt (Palepu, Healy, & Peek, 2010). The outcome of the WACC formula is controlled for the tax advantage of debt (Palepu et al., 2010). The formula for calculating the WACC is as follows:

$$\mathrm{WACC} = \frac{E}{D+E}(r_e) + \frac{D}{D+E}(r_d)(1-t)$$

Where:
E = market value of equity
D = market value of debt
r_e = cost of equity
r_d = cost of debt
t = corporate tax rate

Figure 4.2: The weighted average cost of capital (WACC) formula. Source: Palepu et al. (2010)

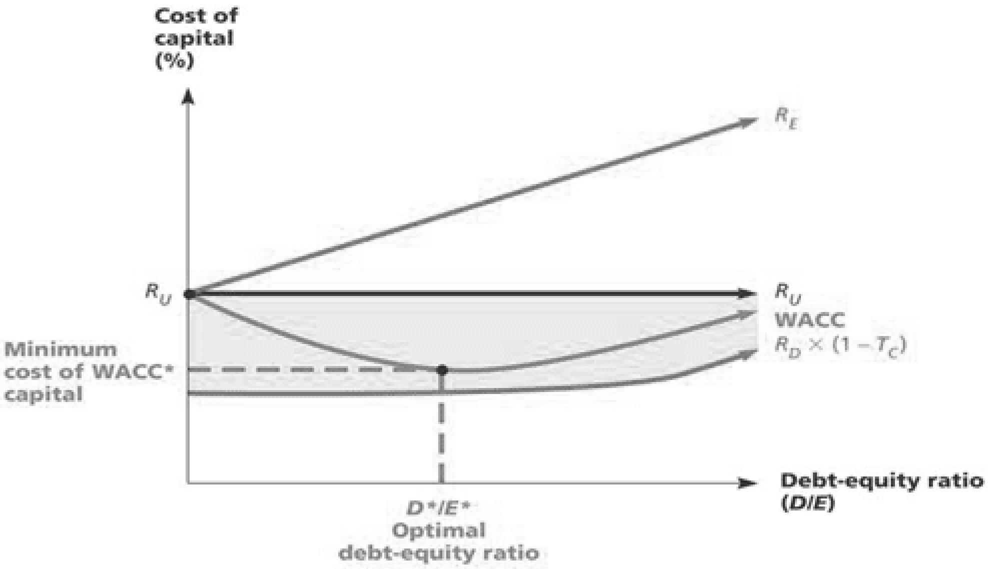

Figure 4.3: The optimal capital structure where there is a balance between an all-equity and all-debt financed firm. Source: Hillier et al. (2010)

According to Meyers (1984) the capital structure of an organization is the result of a series of financial decisions with the goal to reduce inefficiency. This theory is called the pecking-order theory which is based upon information asymmetry (Myers, 1984). According to the pecking-order theory, the amount of debt in a firm is inherent to the discrepancy of internal cash flow, dividends, and investment opportunities thus there is no particular ratio which indicates the best amount of debt (Shyam-Sunder & Myers, 1999). The interest tax shields and cost of financial distress are of less significance in this theory (Shyam-Sunder & Myers, 1999). According to Shyam-Sunder and Myers (1999) the difference in debt ratios between organizations is inherent to the need for external financing instead of reaching an optimal debt ratio. Organizations that do not have enough equity capital to exploit their large investment opportunities, rely more on debt than organizations with large amounts of equity capital and minor investment opportunities (Shyam-Sunder & Myers, 1999).

Another factor that may influence the capital structure of a family firm are the agency costs. Agency costs refers to the disagreement between shareholders and managers (Jensen & Meckling, 1976). A shareholders interest is to increase the profit of the firm and thus de dividends paid to the shareholder, while the managers want to grow the company and maximize their own power (Jensen & Meckling, 1976). These goals may not be aligned with each other which leads to agency costs (Jensen & Meckling, 1976). According to Anderson, Mansi, and Reeb (2003) the agency costs are of influence on the capital structure of the firm, because a manager prefers the use of equity and a shareholder prefers debt. Shareholders create wealth at the expense of debt holders by investing in new projects that are riskier than those presently held in the firm's portfolio (Anderson et al., 2003). Under this scenario, shareholders get most of the gains when the project is a success, while debt holders bear most of the cost (Anderson et al., 2003). The agency cost problem is positively affected by family ownership, because in most cases they are the owner of only one company where all their focus goes out to, the reputation of the family is at stake, and the desire to transfer the family firm to a descendant is of importance (Anderson et al., 2003). Because in most cases a family member is part of the management team and high aversion of risk and the maintaining of control is of great importance in family firms, the agency costs are not a problem (Anderson et al., 2003).

According to Schmid (2013) there are two reasons for family firms to influence the capital structure of the firm. Firstly, family firm owners are large investors who usually only invest in the family firm (Schmid, 2013). This means that the taking of financial risks can harm not only the firm but also the family. That is why family firm owners are excessive risk avoidant (Schmid, 2013). Secondly, control is an important reason to influence the capital structure because of the long-term commitment of the family with the company (Schmid, 2013).

There are three reasons why control is of big importance to the family. Firstly, because of the long-term obligations of the family towards the company (Schmid, 2013). The family firm is the source of income for the generations to come besides that, commitments are being made which span more than one generation (Schmid, 2013). Secondly, the reputation of the family is tied to the success and respectability of the firm (Schmid, 2013). Lastly, the family business is regarded as a legacy for the next generation (Schmid, 2013).

This table is established by summarizing the results of the theory from chapter four.

Capital structure theories
Modigliani & Miller theory: Proposition one: In an efficient market with no taxes, bankruptcy costs, agency costs, and asymmetric information, the value of the levered firm is the same as the value of the unlevered firm. Proposition two: An increase in the debt-to-equity ratio leads to a higher required return on equity because of the bankruptcy costs that come with the risk of debt. This proposition is true in a market with no transaction costs, and if the cost of debt is the same for individuals and corporations.
Trade-off theory: In a market with taxes and tax advantages, firms make an assessment of debt advantages against the cost of financial distress in order to optimize the market value of the firm.
Pecking-order theory: The capital structure of an organization is the result of a series of financial decisions with the goal to reduce inefficiency. This theory is called the pecking-order theory which is based upon information asymmetry. According to the pecking-order theory, the amount of debt in a firm is inherent to the discrepancy of internal cash flow, dividends, and investment opportunities thus there is no particular ratio which indicates the best amount of debt. The interest tax shields and cost of financial distress are of less significance in this theory.
Agency cost theory: The agency cost problem is positively affected by family ownership, because in most cases they are the owner of only one company where all their focus goes out to, the reputation of the family is at stake, and the desire to transfer the family firm to a descendant is of importance (Anderson et al., 2003). Because in most cases a family member is part of the management team and high aversion of risk and the maintaining of control is of great importance in family firms, the agency costs are not a problem (Anderson et al., 2003).

Figure 4.4: Capital structure theories

This figure is established by summarizing the results of the theory from chapter four.

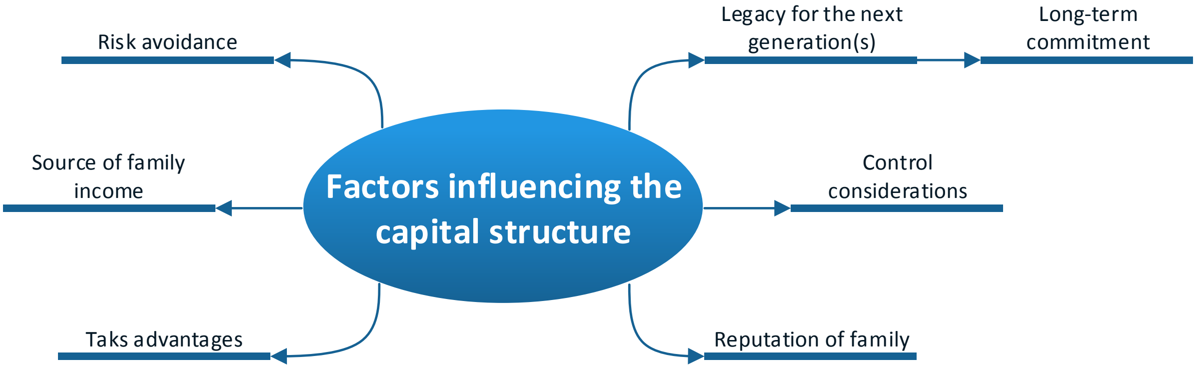

Figure 4.5: Factors influencing the capital structure choices in family firms

5. The influence of the banking crisis on financing policy and family business succession

The banking crisis started in September 2008, due to this crisis the lending to companies declined across all types of loans such as loans for investments, buyouts, takeovers and succession (Ivashina & Scharfstein, 2010). This reduction in loans of banks to companies is, besides the decrease in financing requests, partly due to the fact that banks reduced their lending (Ivashina & Scharfstein, 2010). In this chapter the question: *What does the financing policy towards family firms look like, and was this different before the crisis of 2008?* will be studied. The results of the in-depth interviews are used to supplement this chapter and to answer the sub-question.

In the years before the crash of 2008, the commercial banks and mortgage providers in the US and UK were lending the ordinary people too much money, in particular for mortgages (Luyendijk, 2015). This lending behaviour could continue as long as it did because the borrowing resulted in the increase of the housing prices where everybody thought they were fortunate (Luyendijk, 2015). Furthermore, the commercial banks and mortgage providers did not see any reason for default because the mortgages could be resold to investment banks who in turn would split them up and repackage them into increasingly complex financial products (Luyendijk, 2015). Because the Central Banks kept the interest rates low, pension funds and other investors were happy to buy these financial products because of the better returns (Luyendijk, 2015). The pension funds and other investors trusted the American insurance giant AIG, who insured a lot of these financial products (Luyendijk, 2015). AIG insured these products because the credit evaluators classified these products as ‘triple-A’ or ‘absolutely not risky’ (Luyendijk, 2015).

The products became increasingly complex, the amount of ‘triple-a’ products grew and meanwhile banks kept part of the financial products to themselves, without ensuring proper buffers and often obscured by constructs in tax havens (Luyendijk, 2015). In the year 2007 million of mortgage owners, particularly in the US, were unable to fulfil their financial obligations (Luyendijk, 2015). The complex financial products wherein mortgages were repackaged, decreased in value or ‘exploded’ and became worthless (Luyendijk, 2015). Investors had to take their losses but a lot of banks kept these products to themselves whereby they also had to write off their losses. But because of opaque products and fiscal constructions, nobody knew how much to write off (Luyendijk, 2015).

The concerns about the conditions of the financial institutions led to the fact that panic arose which resulted in bankruptcy and government takeovers of for example Lehman Brothers (Ivashina & Scharfstein, 2010). After the government actions, to help the financial institutions improve their solvency and liquidity, in many commodities and asset classes prices fell drastically, the prices of bank and corporate borrowing increased, and the financial market became extremely unpredictable (Ivashina & Scharfstein, 2010). During the financial crisis of 2008 bank borrowing decreased considerably for all types of loans (Ivashina & Scharfstein, 2010). This decrease can be attributed to the reduced demand in financing because firms are less eager to invest in uncertain times due to the recession, but at the supply side financing was also decreasing.

According to Ivashina and Scharfstein (2010) new debt to large receivers decreased with a percentage of 37 points (in comparison with the prior three months) between September and November in 2008 and even 68 percent points lower than the high point of the “credit boom” of 2007. Ivashina and Scharfstein (2010) state that the number of capital calls decreased evenly for real investment as restructuring. According to Chava and Purnanandam (2011) in a market where there is no information asymmetry and other frictions, borrowers can easily gain capital from other sources than banks in case of shortage in supply of loans.

Financial institutions with limited access to deposit financing decrease their lending more than institutions with more access to this financing form (Ivashina & Scharfstein, 2010). Furthermore, the investments and funds for which continuous credit is needed is more and more decreasing (Ivashina & Scharfstein, 2010). Ivashina and Scharfstein (2010) state that this decline in investments and funds is attributable to firms with low credit ratings who are concerned about their access to debt. This act may be helpful to these firms, but they limit the financial institutions to issue new loans (Ivashina & Scharfstein, 2010).

6. Analysis

In this chapter the interviews are analysed in the order of the theory chapters. The four sub-questions that have been used to answer the research question more specific are listed and elaborated upon in this chapter. For each sub-question the information from the seven interviews is analysed separately on differences and similarities. These are then referred to in the analysis.

1. *What type of financing do family firm owners prefer?*

According to all the respondents of the in-depth interviews, family firms prefer internal financing over external financing. In family firm succession the selling party, usually the parent, is inclined to act as financier instead of the bank or a combination of those two. This is called a subordinated loan where the issuer receives interest payments. There are rules for loans between family members. It is obvious that the tax authorities do not want to miss making money on succession financing because gift tax is being avoided. Thus the selling and buying party are obligated to use market interest rates. Usually the tariff of the bank is used with a higher interest margin because the bank has all the securities. Mr. Z states that an interest rate between 4-12% is defendable. According to Mr. V in practice the banking interest is used with an extra margin of 1%. In most cases though the succession financing is done by the selling party and the bank.

According to Mr. Z it is usually the case that the operating company is bought out and after that the property and/or the machines. In this case the owner stays property owner for a while and receives rental income. The sale of the family firm from the owner to the successor takes place in the holding company by the use of a loan. In the figure below the owner sells the shares from the holding to the holding of the successor for €100, - in the form of a loan.

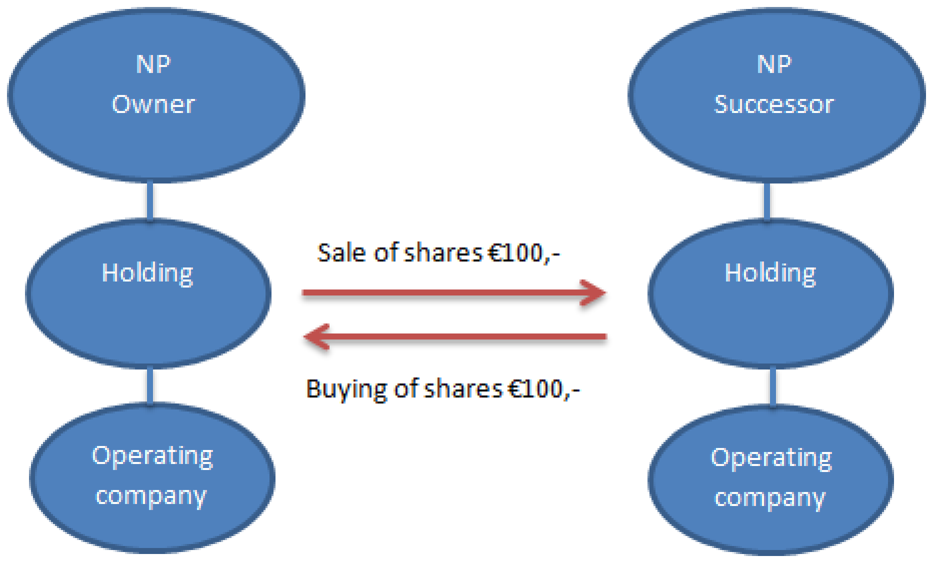

Figure 6.1: loan between owner and successor. Source: Interview with Mr. Z

The Dutch business succession facility was introduced in 2010 by the Dutch government. By using this facility, family firm owners can donate their business to their children with a tax exemption of 100% when the firm value has a maximum of €1.055.022, - (2015). The company value above this amount, the tax exemption of 83% applies. The amount of the exemption applies to the entire inheritance of the company. Thus, each heirs acquired value is not looked at separately. The condition for using this facility is, among others, that the shares are not allowed to be sold to other parties for five years. In order to use this facility, the value of the family firm has to be assessed by an external party that is specialized in for example mergers and acquisitions. By the use of cost price methods like the discounted cash flow, the value of the company can be determined. It is advantageous for the successor(s) that the value of the company is valued as low as possible. This is done to keep the amount paid to taxes limited for the part that is not exempted. From the interviews it became clear that this facility is used in almost all cases of family firm succession.

In succession financing all the securities for the banks are already used up by other forms of financing. From the interviews it became clear that succession financing by banks thus usually takes place with guaranteed credit by the government. The advantages of guaranteed credit by the Dutch government is that in case the family firm goes bankrupt, the bank is insured to get 90% of his invested money back. Another advantage is that the interest on the loan is lower because there is less risk for the bank. The disadvantage of guaranteed credit is that it is expensive. 3% of the state guaranteed sum has to be paid in advance to the government. Furthermore, the guaranteed credit has a maximum of 2 million euro. Besides that the successor has to start the repayment after six months and the loan has to be paid off in six years. The guaranteed credit will not affect the successor directly, the bank arranges this and takes it up in the financing application and financing agreement.

Mr. Z and Mr. V mention another incentive from the Dutch government is the guaranteed firm financing (GO) facility. This facility is for medium enterprises where the loan has to be at least 1.5 million with a maximum of 50 million. The loan has to be paid off in eight years and the interest is based on the Euribor rate. The bank is responsible for 50% of the investment and in case of bankruptcy, the bank loses this 50% invested amount. One of the conditions of the “GO” facility is that the company mainly operates in the Netherlands.

Preferred type of financing by family firm owner
Internal over external financing
Subordinated loan by parent/previous owner
Previous owner temporarily stays property owner and receives rental income
Dutch business succession facility
Guaranteed credit by the government
Government incentive: “GO” facility

Figure 6.2: Preferred type of financing by family firm owner

2. *Do family firms prefer debt over internal equity financing?*

According to Mr. T, Mr. U and Mr. N, the advantage of financing with equity in the form of a subordinated loan is that the successor is not depending on banks. In case the family firm is going through tough times and there is not enough money to pay the interest and repayments to father it is possible, in consultation between father and sons, to defer repayments and interest. Additionally, for the previous owner it is also important that the company remains healthy because here the yield on the loan should come from. It is possibly less interesting for a bank to fund the succession process because the money leaves the company and is not used for new activities or production facilities. Mr. X states that by using equity financing the company shows a positive image towards the society because of the low leverage. This image is often looked at by for example investment firms, supplier and project managers. It is not self-evident for a family business to make use of equity financing. It is important that the former owner does not need the money immediately. If he/she wishes to withdraw from the company immediately, external financing would be necessary.

The disadvantage of equity in the sense of a subordinated loan is that it is expensive. The interest on the loan is higher than the cost of debt if you lend money from a bank. Furthermore, the risks are on the previous owner, so if the business deteriorates, it is compromising the previous owner. Furthermore, according to Mr. X the disadvantages of financing with equity are that it is bound to the company. It is impossible to invest your money otherwise once it is reinvested in the company. The previous owner could have made arrangements outside the company for a pension of 50%, and always had the intention to supplement this with the dividend of the family firm. With reinvesting the money made in the sale of the family firm, there is no possibility of dividend payments. In addition, it could be a disadvantage that the previous owner remains involved in the business. There is always a parent looking over your shoulder who wants to continue to participate and keep a grip on the company.

Mr. X states that the risk of debt financing is to become overfunded. In this case the family firm can get in a situation where a bank or a third party is overruling the director or manager of the company. These parties can demand higher payments and place an expert from outside in the company who is tasked with watching and evaluating the management. Furthermore, if a family firm is going through tough times, banks are more likely to call for crisis management than before the crisis of 2008.

An advantage of debt financing is if an expert is placed inside the company, it can give some new insights and show opportunities in the market. Another advantage is that its interest rate is lower than that of a subordinated loan, whereas the subordinated loan is more flexible in delaying the repayment period.

	Debt financing	*Internal equity financing*
Advantages	Interest rate is lower than that of a subordinated loan; Special management can give new insights in market opportunities.	Not dependent on banks; Flexible in payments; Positive image.
Disadvantages	Banks may not be willing because the money leaves the firm and is not used for growth of the firm; Risk of becoming overfunded; Special management; Not flexible.	Risks are for the previous owner; Amount of loan depends on wishes of previous owner; High interest rate; Bound to the company; Previous owner stays involved.

Figure 6.3: Advantages and disadvantages of debt and equity financing

3. *What are the major factors influencing the capital structure of family firms?*

According to all the respondents the factors as a high aversion of risk and the loss of control motivates family firm owners to use less debt and to rely more on equity because the banks take all the firms securities. Mr. V states that for family firms control is more important than for non-family firms. The owner of a family firm finds it difficult to cope with the control of an external party because they see their firm as their child and their proud. Family firms are in most cases less levered than non-family firms.

In opposition to the control considerations, the tax advantage of debt motivates to use debt, but in times of low interest rates this advantage is small. Mr. X thinks this tax advantage of debt will change in the future. The Dutch government has the intention to change the tax system. It contemplated to change the tax law by lowering the corporate income tax. Furthermore, the amount of interest paid on debt capital will not be deductible from taxable profits. A company that is highly levered will pay a lot more corporate income tax than before because of this new tax law.

Factors as long-term commitment to the firm, the source of income, and the reputation of the family play an important part in making financing decisions. Family firm owners will stop at nothing to prevent bankruptcy and to uphold the family name. The proud of the family is a very important incentive. Furthermore, Mr. X states that a lot attention is paid to business owners by their surroundings

According to all the respondents there is no difference in family firms in need of succession financing when it comes to firm size.

Factors influencing the capital structure
High aversion of risk
Risk of losing control
Banks take all the securities
Pride in the company
Tax advantage
Long-term commitment
Source of income
Reputation of the family
Attention from environment

Figure 6.4: Factors influencing the capital structure choices in family firms

4. *What does the financing policy towards family firms look like, and was this different before the crisis of 2008?*

According to all the respondents, there is a difference in the financing of family firms by banks before and after the crisis of 2008. They all state that the succession process of family firms is still fundable by banks as ING, Rabobank, and ABN-AMRO but the amount of financing has decreased. The banks ask more investment from the selling party in the succession process. Before the crisis of 2008 there was a lot more competition in the banking sector, for example "Staalbankiers" was aggressively taking over the financial market of succession financing in the Netherlands. After the banking crisis these "exotics" in the market have disappeared.

Mr. X and Mr. T state that before the crisis of 2008 it was for business owners important to be able to show a good revenue model with an equity/solvability rate of 20%, if that was the case the banks would finance the entire amount of financing demand. Nowadays the equity/solvability rate should be 25-30% before banks are willing to invest. If this rate is not achievable, money must be provided by another party like the previous owner or the successor.

Mr. U and Mr. N state that banks look at succession financing as it is any other form of funding application. According to Mr. Z the rule of thumb in the amount the bank is willing to invest is 3,5 times EBITDA. Besides that banks preform market research and confront the owner and successor with these outcomes.

Firm analysis	***Financial analysis***	***Banking position***
Successor/new owner Vision and strategy Relevant knowledge and experience +	Profitability: future and past Sensitivity developments market Cash flow Liquidity +	Securities Commitment of successor with firm and bank Security deposit on natural person -
Preforming Legal structure Firm activities Internal organisation +	Equity compared to balance sheet total Solvability -	

Figure 6.5: Banking model of business analysis. Source: Interview with Mr. Z

The above mentioned table contains the decision making process of banks in succession financing. The first column contains the firm analysis. In succession financing it is very important that the successor knows what he/she is taking over and that there is a relevant background like experience and knowledge. Furthermore, the successor needs a well-founded strategy and vision about the company. This part of the firm analysis is most important. If it scores below standard, the succession is not likely to be financed. The second subject in firm analysis is the market where the company is in. Is it a growing market? Are there particular opportunities or threats? Even if the company is in a bad preforming market this does not need to be a problem for the financing, but the successor has to be able to show that the company is preforming better than the market and the successor has well-founded ideas to keep doing so.

The financial analysis in the next column speaks for itself. The profitability, liquidity, cash flow etc. has to be sufficient in order be eligible for financing. According to Mr. Z the equity position and the solvability are usually insufficient but this will get better if the above mentioned profitability etc. is good.

The last column mentions the banking position. What are the securities? Is the successor committed to the firm and the bank? Can we place a security deposit on the natural person? According to Mr. Z three of the five above mentioned columns have to be sufficient in order to receive financing from a bank. Usually the score is as shown in the figure. It is not obligated by banks for the successor to have worked some time at the company but it does have preference.

According to Mr. T, due to the financial crisis the conditions and requirements of banks have become stricter. According to Mr. V the long term results have become more important since the banking crisis of 2008. In the past historical results and a small forecast were enough to get financing from a bank, nowadays a well-founded business plan is needed with information about the financing requirements and future prospects of the entrepreneur. Besides that banks expect more financial input, often 10% of the financing request, and commitment from the business owner. This can be done in the form of a surety. The equity and debt capital ratio of a firm is also an important factor in evaluating financing requests.

Besides that there are less providers of debt on the market. According to Mr. Z it is important that the competition in the market increases. There is no healthy playing field in the financial market because there is no natural market operation with a “survival of the fittest”. There are so many rules and regulations that small banks cannot exist, because they cannot carry the compliance costs. Besides that, large banks as the ING, ABN-AMRO and Rabobank cannot go bankrupt because they will be saved by the government. The Dutch state will stop at nothing to prevent bankruptcy of banks. While they should do everything to make sure that it is no problem for the Dutch economy is a bank goes bankrupt. Banks have become government businesses where there is no incentive to handle the money with care. Because of that you get excesses like investing in lousy projects. According to Mr. Z, banks should become smaller and the government must use rules and regulations to do so. Thereby new banks will rise and the natural “survival of the fittest” will be retrieved. Mr. X does not agree with Mr. Z, he thinks it is best if all banks are regulated by the government.

Mr. Z, Mr. W and Mr. V state that their clients have not searched for other forms of financing because of the trust issues they had with their bank after the crisis. There are other forms of financing that are used in succession financing like investment firms, private equity and venture capital companies, but in these cases there is usually the desire to continue fast growth of the company. Mr. X did search for other financiers because of the crisis and in the past this financing would have been done by their principle banker. In this case Mr. X searched for the cheapest form of financing. Mr. X states that he has no trust issues with the banks after the banking crisis of 2008 but the image of the bank employees is severely damaged. Nowadays companies are submitted much faster to special management within a bank. In case of special management, external specialist will enter the firm and tell you what to do. These specialists often have no knowledge of the firm and the entrepreneur. They will decide what it is worth to the bank to save the company.

According to Mr. Z, Mr. W, Mr. T and Mr. V there has been a decrease in financing requests after the crash of 2008. In times of crisis companies are less likely to invest and thus ask for less financing. Because of the media a lot of business owners thought that getting financing from banks was almost impossible. Regarding succession financing, the business owner could not sell his company for wat it was worth after the crisis of 2008. Before the crisis selling prices of 7-10 times the profit of the firm were normal, while banks only financed 5-6 times the profit. Nowadays the selling prices are normalized to 5-6 times the profit and the bank financing to 2-3 times the profit. What you see is that there is a gap between the selling price and the amount the bank is willing to invest. So there is more need for other forms of financing besides the bank. Due to the crisis banks are less willing to be at risk because in the past they have undertaken to much risky projects of which they are still feeling the consequences. According to Mr. V the interest rates that the banks take for investment projects will increase.

Mr. X believes that the future will bring a system besides the banking system. Like the block chain initiative where virtual money is transferred and cards with credit are issued. This is direct accounting on each other’s customer card without involvement of banks. Mr. X is confident that in the future there will be a virtual financial world, because banks have not learned from their mistakes and scandals. The “me, myself and I” culture is still in place and quick enrichment is the standard. Mr. V states that the financing of succession or other forms of investments is changing from strictly bank funding to a combination of financing parties like the bank, the owner, the state with guaranteed credit, leasing companies, and private equity firms. This means that the part of the bank is becoming smaller in financing and in its place will take the form of a consultancy firm which brings together all the financing parties. The overall financing to the company will go through the bank. Furthermore Mr. V thinks that the future will bring new financing alternatives. The internet will become a greater source of investment providers. Company E has become too expensive to issue small loans of for example 50.000 euro. At Company E the ZRF is developed for entrepreneurs who need maximum funding of 1 million euros. The entrepreneur has to enter his business plan and financing request online. Within a few days this entrepreneur will get a positive or negative answer on his financing request.

Mr. V states that Company E is still keen on financing family firms because of their long term commitment to the company. In these types of businesses, financing is done to reap the benefits in the long term while non-family firms often undertake investments to enhance the profits of the firm on the short term. In most cases family firms have stable management teams which is also very important for banks to make financing decisions.

Mr. Z, Mr. W, Mr. T and Mr. V state that in succession financing, the management buy-in is almost un-fundable by banks. In these cases the banks do not know the successor and there is often a lack of management experience. The selling party, the owner, is responsible for the majority of the financing because the banks are not willing to take risks in relation to the manager that is buying in.

Factors that play a part in reviewing succession financing applications	See table 6.5; Equity/solvability rate; Profitability; Business case and forecasts; Successor; Securities.
Difference in financing policy between family and non-family firms	Banks are more eager to invest in family firms because of their long-term commitment; Family firms are generally healthy companies with low leverage.
Change in financing policy of banks after the crisis of 2008	More investment from selling and buying party; Less risk for banks; Less competition on the financial market; Equity/solvability rate of 25-30%; Business case is very important with well-founded forecasts; Requirements and conditions are stricter; Commitment from business owner; Submitted faster to special management.
Decrease in financing requests	Decrease in financing requests due to crisis; More financing requests have been rejected since the crisis.
Risk of succession for banks	Banks look at succession financing as it is any other form of financing.
Other forms of financing	Private equity; Venture capital companies; Guaranteed credit; Other banks.
Trust issues due to crisis	Family firms did not search for other forms of financing due to trust issues; The image of banks is damaged.

Figure 6.6: The effect of the banking crisis on financing policy and family firm succession

7. Conclusion, limitations, and recommendations

In this chapter the results of the study are interpreted. First, the implications of the analyses are discussed with consideration of the discussed theories. Second, the limitations of this study are discussed and recommendations for future research are formulated.

7.1 Conclusion

The topic family business succession has received a great amount of attention from academic researchers and business practitioners. However most of the research has focused on studying the personal factors, succession process factors and firm factors that influences family business succession. There is limited information available about the way family business succession is financed and how the crisis of 2008 affected this financing process. The research question that is answered in this thesis is:

In what way did banking crisis influence the lending behaviour of banks towards family business succession?

According to theory and practice there is a difference in the financing policy of family firms by banks before and after the crisis of 2008. The results of the interviews show that since 2010 almost all succession financing is done by the use of the company succession facility where a large sum of the firm value can be donated to the children tax free. In cases that the selling party wanted to cash out, external financing was needed. The succession of family firms is still fundable by banks but the proportion of funding by banks has decreased. Before the banking crisis of 2008 the past historical results and a small forecast were enough to get financing from a bank. Nowadays a well-founded business plan is needed with corresponding information about the financing request, the long-term results, and the future prospects of the entrepreneur. Furthermore, banks expect more financial input from the selling party which is often 10% of the financing request.

Due to the crisis companies are submitted faster to special management within a bank when their results are deteriorating or if they ask for deferment of payment. Another result of the banking crisis is that there are less debt providers on the market. There are so many rules and regulations that the compliance is so expensive that new banks cannot rise and small banks cannot exist.

Family firms do not search for other forms of financing because of trust issues towards banks but their image of bank employees is severely damaged. The amount of financing requests did decrease because of the crisis. In times of crisis companies are less likely to invest and thus ask less for financing, also more financing requests were rejected by banks. Regarding succession financing the business owner could not sell his company for what it was worth.

Research has shown that the financing of succession and other forms of investments is changing from strictly bank funding to a combination of financing parties like the bank, the owner, the state with guaranteed credit, leasing companies, and private equity firms. This means that the part the bank is playing in financing is becoming smaller and in its place it will take the form of a consultancy firm which brings together all the financing parties.

Before the banking crisis of 2008	***After the banking crisis of 2008***
No of little investment from selling and buying party	More investment from selling and buying party (10%)
Risky investments	No risky investments
Much competition on financial market and new banks starting up	Almost no competition and no new banks starting up
Equity/solvability firm 20%	Equity/solvability firm 25-30%
History of the firm	Business case with well-founded forecasts
Requirements and conditions	Requirements and conditions much stricter
No or little commitment from business owner	More commitment from business owner
Special management rare	Special management more common
Financial requests	Decrease in financial requests and rejections
No trust issues	No trust issues
Image of banks perfect	Image of banks damaged

Figure 7.1: comparison lending behaviour of banks before and after the crisis

This study adds to the existing literature by providing an insight on the drivers of the choice in type of financing and if the banking crisis affected the external succession financing. This study provides managers of family firms with an understanding of the factors that influence their decision making with regard to succession financing. Managers may use the provided knowledge in their decision making process regarding succession financing. The results of this study may also provide some new insights with regard to the multiple financing possibilities of succession.

The answer on the research question may be useful for managers of family firms that are searching for external succession financing. It may be a reason to look for other financing types. Besides that, the outcome of this analysis can be useful for Dutch banks on the field of financing policy toward family firms, especially the ones that need financing for succession.

7.2 Limitations

The limitations of this research from the methodology point of view are that it can be said that the data collection from the interviews is not reliable in the sense that the same study will not lead to the same results. This is thus a validity and reliability problem. Furthermore, the research is not generalizable because there is made use of a small group of respondents. Also, random sampling was not used because there were limited family firms that contributed to the research, because in general family firms are not eager to disclose private information. The sample is also limited to Dutch firms. It is expected that national factors are influencing the outcome of this research because of for example the Dutch company succession facility. Further research, including multiple countries, would be necessary to identify what types of financing are commonly used in succession financing and what the effects of the crisis are on the financing of family firm succession.

7.3 Recommendations

I would like to see more research on the effect of the banking crisis on family firms outside the Netherlands. This study has purely focused on the effect it had on Dutch firms and I am curious what the effects were outside the Netherlands. Future studies could provide family firm owners with an understanding of the factors that influence succession financing with regard to the financial crisis of 2008. Furthermore, a larger sample should be used in order to make generalisations about the effect of the crisis. Research has shown that external succession financing is not often used in the Netherlands because of the Dutch company succession facility. Future research thus needs to focus on firms that were transferred before this facility was introduced.

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Appendix 1: Questionnaire for family firms

- Is there a difference in financing policy and types of financing by banks before and after the banking crisis of 2008?
- What type of financing did your company use for the succession process?
- According to theory the previous owner often contributes to the financing of the succession process, is this the case in your company?
- What does this financing type look like?
- How is the interest rate on these loans determined?
- What size of family firms are looking for external financing for succession related expenditures?
- What variables determine the investment amount that the previous owner is willing to contribute to succession financing?
- Is government interaction in the form of guaranteed credit common in succession financing?
- What are the advantages and disadvantages of equity financing?
- What are the advantages and disadvantages of debt financing?
- Does the tax benefit of debt lead to the choice of using debt financing?
- Research shows that a high aversion to control risks motivates family firm owners to use less debt and rely more on internal financing? Is this also the case in your company?
- Risk avoidance is also a reason to use less debt and rely more on internal financing. Is this also the case in your company?
- Do factors as long-term commitment to the firm, source of income, and the reputation of the family play a part in making financing decisions? Why?
- Which forms of pay-out policy are commonly used towards the previous owner?
- Did your company search for other forms of external financing after the crisis?
- Are there trust issues with banks after the crisis of 2008 in your company?
- What changed in the financing policy toward family firm succession after the crisis of 2008?

Appendix 2: Questionnaire for financial service providers

- Is there a difference in financing policy and types of financing by banks before and after the banking crisis of 2008?
- What type of financing is commonly used in succession?
- What type of equity or debt is commonly used?
- Is there a difference in financing type and policy between family and non-family firms?
- What size of family firms are looking for external financing for succession related expenditures?
- According to theory the previous owner often contributes to the financing of the succession process, is this in practice also common?
- What does this financing type look like?
- How is the interest rate on these loans determined?
- What variables determine the investment amount that the previous owner is willing to contribute to succession financing?
- Is government interaction in the form of guaranteed credit common in succession financing?
- What is more common in practice, equity or debt financing?
- What are the advantages and disadvantages of equity financing?
- What are the advantages and disadvantages of debt financing?
- Does the tax benefit of debt lead to the choice of using debt financing?
- Research shows that a high aversion to control risks motivates family firm owners to use less debt and rely more on internal financing? Is this also the case in practice?
- Risk avoidance is also a reason to use less debt and rely more on internal financing. Is this also the case in practice?
- Do factors as long-term commitment to the firm, source of income, and the reputation of the family play a part in making financing decisions? Why?
- On what factors do banks assess the financing requests of family firms with regard to succession?
- Why are banks more eager to finance management buy-outs than management buy-ins?

- What changed in the financing policy toward family firm succession after the crisis of 2008?
- Did family firms search for other forms of external financing after the crisis?
- Is there a decrease in financing requests after the crash of 2008 compared to the situation before the banking crisis?
- Do family firms have trust issues with banks after the crisis of 2008?
- How do banks assess the risks that come with succession financing?
- Which forms of pay-out policy are commonly used towards the previous owner?

Appendix 3: Interview with Company A

Interview Company A

Date: 19 June 2015

Present: Mr. Z – owner of Company A

Lotte Wolters - student at the University of Twente

Place: Almelo

According to Mr. Z there is a difference in the financing of family firms by banks before and after the crisis of 2008. Mr. Z states that the succession process of family firms is still fundable by banks as ING, Rabobank, and ABN-AMRO but the amount of financing has decreased. The banks ask more investment from the selling party in the succession process. Before the crisis of 2008 there was a lot more competition in the banking sector, for example “Staalbankiers” was aggressively taking over the financial market of succession financing in the Netherlands. After the banking crisis these “exotics” in the market have disappeared.

Mr. Z states that in succession financing, the management buy-in is almost un-fundable by banks. In these cases the banks do not know the successor and there is often a lack of management experience. The selling party, the owner, is responsible for the majority of the financing because the banks are not willing to take risks in connection to the successor.

According to Mr. Z there is no difference in family firms in need of succession financing when it comes to firm size. In succession financing banks are often used as financier where the parents usually act as co-financer. The loan from the parents is subordinated in relation to the bank loan because banks are risk avoidant. In most cases the bank is paid off first and thereafter the parents of the successor.

In family businesses there is often already bank financing in place for matters such as mortgage loans on the building(s), stock financing, and accounts receivables. For succession financing all the securities are already used up. Succession financing by banks thus usually takes place without guarantees or with guaranteed credit by the government. The advantages of guaranteed credit by the Dutch government is that in case the family firm goes bankrupt, the bank is insured to get 90% of his invested money back. Another advantage is that the interest on the loan is lower because there is less risk for the bank. The disadvantage of guaranteed credit is that it is expensive. 3% of the state guaranteed sum has to be paid in advance to the government. Furthermore, the guaranteed credit has a maximum of 2 million euro. Besides that the successor has to start the repayment after six months and the loan has to be paid off in six years. The guaranteed credit will not affect the successor directly, the bank arranges this and takes it up in the financing application and financing agreement.

Another incentive from the Dutch government is the guaranteed firm financing (GO) facility. This facility is for medium enterprises where the loan has to be at least 1.5 million with a maximum of 50 million. The loan has to be paid off in eight years and the interest is based on the Euribor rate. The bank is responsible for 50% of the investment and in case of bankruptcy, the bank loses this 50% invested amount. One of the conditions of the “GO” facility is that the company mainly operates in the Netherlands.

In family firms the selling party is inclined to act as financier himself instead of a combination with a bank. The mind-set behind it is that if the owner cashes out, he will not get much interest on his savings account and besides that the family firm and successor are heavily funded by a bank. Investing the money in for example stocks or bonds is risky and thus the owner often decides to invest all or some of the money back into the family firm in the form of a subordinated loan. Thereby the owner keeps some form of connection with the family firm and he/she gets a nice return on the investment.

An advantage of succession financing in the family is that the owner does not feel the need to maximize the selling price. Besides that the repayment period can be kept flexible.

There are rules for loans between family members. It is obvious that the tax authorities do not want to miss making money on succession financing because gift tax is being avoided. Thus the selling and buying party are obligated to use market interest rates. Usually the bank tariff is used with a higher interest margin because the bank has all the securities. With some good story telling an interest between 4% and 12% percent is defendable.

In practice the successor does not bring in any money in the financing process because he/she simply has no money. If the successor does have money, he is obligated by the bank to invest this amount in the succession process. It occurs that other family members bring in extra money to finance the succession process, but Mr. Z has never witnessed this type of financing in succession. Nevertheless, in most cases the financing is done by the selling party in combination with the bank. The more investors, the more opinions have to be taken into account.

According to Mr. Z it is usually the case that the operating company is bought out and after that the property and/or the machines. In this case the owner stays property owner for a while and receives rental income. The sale of the family firm from the owner to the successor takes place in the holding company by the use of a loan. In the figure below the owner sales the shares from the holding to the holding of the successor for €100, - in the form of a loan.

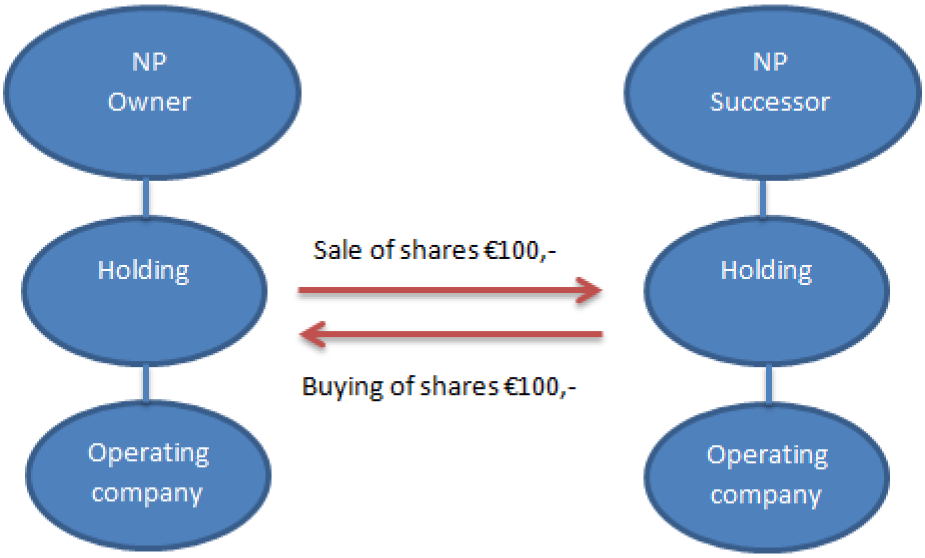

Figure 6.1: Loan between owner and successor: Source: Interview with Mr. Z

The advantage of financing with equity is that the successor is not depending on banks and that if times are tough for the company, it can take a beating. The disadvantage is that it is expensive. The return on the investment is usually 15% and the successor can lend money at the banks for 4%. If you look at the interest rate of equity, you should use less of it. But if you use too much debt, the bank can declare bankruptcy in tough times. So there has to be a healthy balance in this.

Mr. Z states that a high aversion of control risks motivates family firm owners to use less debt and to rely more on equity financing because the banks take all the securities. After the banking crisis of 2008 the trust in banks has decreased enormously. The words that are often spoken are: “The first thing I will do is to be no longer dependent on a bank.” In opposition to the control considerations, the tax advantage motivates the successor to use debt, but in the times when the interest rate is low this advantage is small. Factors as long-term commitment of the family, source of income of the family and the reputation of the family play an important part in making financing decisions. Family firm owners will stop at nothing to prevent bankruptcy and to uphold the family name. Proud is a very important factor.

Banks look at succession financing as it is any other form of funding application. According to Mr. Z the rule of thumb in the amount the bank is willing to invest is 3,5 times EBITDA (equity before interest, tax, depreciation and amortization). Besides that banks preform market research and confront the owner and successor with these outcomes.

Firm analysis	**Financial analysis**	**Banking position**
Successor/new owner Vision and strategy Relevant knowledge and experience +	Profitability: future and past Sensitivity developments market Cash flow Liquidity +	Securities Commitment of successor with firm and bank Security deposit on natural person -
Preforming Legal structure Firm activities Internal organisation +	Equity compared to balance sheet total Solvability -	

Figure 6.2: Banking model of business analysis. Source: Interview with Mr. Z

The above mentioned table contains the decision making process of banks in succession financing. The first column contains the firm analysis. In succession financing it is very important that the successor knows what he/she is taking over and that there is a relevant background in experience and knowledge. Furthermore, the successor needs a well-founded strategy and vision about the company.

This part of the firm analysis is most important. If it scores below standard, the succession is not likely to be financed. The second subject in firm analysis is the market where the company is in. Is it a growing market? Are there particular opportunities or threats? Even if the company is in a bad preforming market this does not need to be a problem for the financing, but the successor has to be able to show that the company is preforming better than the market and the successor has well-founded ideas to keep doing so.

The financial analysis in the next column speaks for itself. The profitability, liquidity, cash flow etc. has to be sufficient in order be eligible for financing. According to Mr. Z the equity position and the solvability are usually insufficient but this will get better if the above mentioned profitability etc. is good.

The last column mentions the banking position. What are the securities? Is the successor committed to the firm and the bank? Can we place a security deposit on the natural person? According to Mr. Z three of the five above mentioned columns have to be sufficient in order to receive financing from a bank. Usually the score is as shown in the figure. It is not obligated by banks for the successor to have worked some time at the company but it does have preference.

Because of the financial crisis the conditions and requirements of banks have become stricter. Besides that there are less providers of debt on the market. According to Mr. Z it is important that the competition in the market increases.

After the banking crisis the ABN-AMRO and ING needed help from the government and thus were not allowed to compete on interest rates. The Rabobank wanted to make money and thus did not lower its interest rate. This has changed an improved but not as it was before 2008. There is no healthy playing field in the financial market because there is no natural market operation with the “survival of the fittest”. There is so many rules and regulations that small banks cannot exist. They cannot carry the compliance costs. Besides that, large banks as the three above mentioned cannot go bankrupt because they will be saved by the government.

The Dutch state will stop at nothing to prevent bankruptcy of banks. While they should do everything to make sure that it is no problem for the Dutch economy is a bank goes bankrupt. Banks have become government businesses where there is no incentive to handle the money with care. Because of that you get excesses like investing in lousy projects. According to Mr. Z, banks should become smaller and the government must use rules and regulations to do so. Thereby new banks will rise and the natural “survival of the fittest” will be retrieved.

According to Mr. Z there has been a decrease in financing requests after the crash of 2008. In times of crisis companies are less likely to invest and thus ask for less financing. Because of the media a lot of business owners thought that getting financing from banks was almost impossible.

Mr. Z states that there have not been clients of his that searched for other forms of financing because of the trust issues they had with their bank after the crisis. There are other forms of financing that are used in succession financing like investment firms, private equity and venture capital companies, but in these cases there is usually the desire to continue fast growth of the company.

A common form of pay-out to the owner is by monthly payments. In family circumstances the pay-out policy is flexible. If there is enough money the owner will get payed. It is common practice that at the end of each year the successor pays his parents what he can spare. It is wise to establish a fixed repayment schedule but if it is not achievable it must be able for the successor to deviate from it. The danger without a repayment schedule is that the debt to the parents becomes so high, that it is unpayable in time. Deviating from the repayment period within the family is done by mutually agreement.

Appendix 4: Interview with Company B

Interview	Company B
Date:	30 June 2015
Present:	Mr. Y – owner and director of Company B
	Lotte Wolters - student at the University of Twente
Place:	Overdinkel

Company B is one of the leading international cultivating and trading companies in (…..) specialties. The two sons of Mr. S, Mr. R and Mr. Y, are leading the company in their father's footsteps.

Both sons were working for 20-35 years at Company B before they took over the firm completely from their father. In the year 2001 already 2/3 of the company was taken over by Mr. R and Mr. Y whereby Mr. S still owned 1/3 of the shares. For the transfer of 2/3 of the shares, use was made of a loan from Mr. S with a fixed interest rate and repayment period. In the year 2010 the remaining shares from Mr. S were transferred by the use of a business succession facility.

The Dutch business succession facility was introduced in 2010 by the government under which an exemption of 100% applies with a firm value of € 1.055.022, - (2015). The firm value of Company B was higher than this € 1.055.022, - The amount of money above this value, an exemption of 83% applies. The amount of the exemption applies to the entire inheritance of the company. Thus, each heirs acquired value is not looked at separately. The condition for using this facility is, among others, that the shares are not allowed to be sold to other parties for five years.

In order to use this facility, the value of the family firms has to be assessed by an external party that is specialized in for example mergers and acquisitions. By the use of cost price methods like the discounted cash flow, the value of the company can be determined. It is advantageous for the successor(s) that the value of the company is valued as low as possible. This is done to keep the amount paid to taxes limited for the part that is not exempted. After the firm valuation was done at Company B, no external financing was necessary to finance the succession process. Mr. S sold the shares of his company to his sons whereby a loan was created. The profit that then was generated was used to finance the interest and repayments to Mr. S.

As mentioned before, use was made of a loan from Mr. S with a fixed interest rate and repayment period. The interest rate has to be in conformity with the market, which was jointly agreed upon between the parties. The interest rate has to be acceptable to the tax authorities. Furthermore, the interest rate has to be higher than the market rate because it is venture capital and a subordinated loan and all the securities are used up by the bank.

Mr. Y states that it is wise to let the tax authorities assess the taxation, interest rate and the contracts before they are signed. This prevents discussions with the tax authorities later on which can lead to obligated changes in the contracts and reversing and changing the loan between father and sons. Besides that, the tax could charge an interest and penalty fee. Company B did not let the tax authorities assess the taxation, the contract and the interest rate. At the same day of the succession, the successors transferred the shares to another holding company. This was a regrettable move by Mr. Y and Mr. R because the shares are not allowed to be sold to other parties for five years after the succession. Because of this action, Company B had to pay a fine and additional tax payment to the tax authorities. After heated discussions with the tax authorities they agreed to transfer the shares back to the holding company of Mr. Y and Mr. R and by that a fine and additional tax payments were avoided. Company B now wants to introduce horizontal supervision whereby these before mentioned issues with the tax authorities will be prevented.

Mr. Y and Mr. R chose consciously to borrow money for the succession process from their father because it is cheaper due to the business succession facility and because it is a flexible loan. In case the family firm is going through tough times and there is not enough money to pay the interest and repayments to father it is possible, in consultation between father and sons, to defer repayments and interest. Additionally, for the previous owner it is also important that the company remains healthy because here the yield on the loan should come from. It is possibly less interesting for a bank to fund the succession process because the money leaves the company and is not used for new activities or production facilities.

Mr. Y thinks that the banking crisis of 2008 did affect the succession financing in family firms. After the crisis, the banks must adhere to many more rules and regulations.

Nevertheless, Mr. Y does believe that if you have a healthy business, banks are willing to finance.

Factors such as the sector in which the company operates, the cash flow and the profitability are important for a bank to assess a funding request. Sectors such as construction and textiles were under enormous pressure with disappointing profits thus succession funding would perhaps be difficult here. The food sector where Company B is in has held up well in the crisis. Everyone keeps on eating so in that respect there is no better industry to operate in.

Mr. Y states that he and his brother have no trust issues with their bank. In the year 2007 Company B has undertaken a financing with their bank and have paid off this lone in time. Besides that the company was always able to show healthy returns. Nevertheless, Mr. Y believes that if they had applied for another external financing on top of the succession financing with their father, it would be somewhat problematic in the sense of credit facility, higher interest rates, short repayment schedule, and closing fees. That is why the family of Company B is confident that the choice to finance the succession process internally was wise. It is not self-evident for a family business to make use of internal financing. It is important that the former owner does not need the money immediately. If he/she wishes to withdraw from the company immediately, external financing would be necessary.

An important factor that played a role for the previous owner to invest the money back into the family firm was that he otherwise possibly had to leave the firm. For the first time in his life, Mr. S was able to get extra pocket money out of the company through interest and repayment which was not necessary to directly invest back into the family firm. Owners of family businesses reinvest as much as possible revenues back into the business.

Disadvantages of internal financing are that the risks are on the previous owner, so if the business is making poor returns, it could compromise the interest payments and repayments to the previous owner. In addition, it could be a disadvantage that the previous owner remains involved in the business. There is always a parent looking over your shoulder who wants to continue to participate and keep a grip on the company. Despite this, in the case of Company B, Mr. Y does not experience this as a disadvantage.

Advantages of internal financing are that the total firm value is appraised lower because by doing so, the successor will pay minimal interest and repayments. In addition, the costs are not high taking into account that more than 80% of the shares are transferred tax free. Furthermore internal financing is a flexible loan as mentioned before. In case the family firm is going through tough times and there is not enough money to pay the interest and repayments to father it is possible, in consultation between father and sons, to defer repayments and interest. Additionally, for the previous owner it is also important that the company remains healthy because here the yield on the loan should come from.

According to Mr. Y the avoiding of risks and the fear of losing control plays an important role in the choice between internal or external financing. If parents do not want to be involved in the family firm after succession, Mr. Y advises against internal financing. It is, after all, the money from the previous owners where the family firm is playing with. So it relies upon the intentions of the previous owner if internal or external financing is used. If Mr. S had sold the company there were fewer risks, he could have then cashed out and put his money on for example a savings account. In the case of Company B the money will remain in the company until the loan is paid off. So, throughout the duration of the loan, the money of Mr. S is at risk.

Appendix 5: Interview with Company C

Interview	Company C
Date:	1 July 2015
Present:	Mr. X – Director/manager of Company C
	Lotte Wolters - student at the University of Twente
Place:	Oldenzaal

Mr. Q and Mrs. P are the owners of Company C where the companies C1, C2 and C3 belong to. Company C has 51% of the shares in C3, the other 49% belong to a company of Mr. O, who is responsible for the sales. C1 is responsible for 80% of the revenue and C2 for the other 20%. Company C also has a Stichting administratiekantoor (STAK) in which is stated that Mr. Q and Mrs. P are the representatives of the firm, but if they come to pass, Mr. X will take care of the business as director/manager.

In 2013 C1 was sold first to the two daughters of Mr. Q and Mrs. P. Company C transferred 45% of the shares to Deb BV and 45% to Sem Holding BV. 10% of the shares stayed in Company C because if you rent your building to the two subsidiaries without an equity stake of 10% or more, it is then seen as an investment property and is taxed differently in corporate income tax. The transfer of shares is done by the use of the Dutch business succession facility.

In the year 2014 C2 was transferred to the two subsidiaries. This was a rather easy transfer of shares because the holdings of the two daughters were in place. Mr. X, with his background in accountancy, valued the shares and let the tax authorities approve of its value. Company C transferred 45% of the shares to Deb BV and 45% to Sem Holding BV. After a visit to the notary everything was taken care of. After the establishment of the subsidiaries, Mr. X became director/manager at Deb BV.

The STAK of Company C determines whether a dividend is paid. That means that the STAK can block all the decisions of the owners of Deb BV and Sem Holding BV. By being director/manager in both the STAK of Company C and in Deb BV, Mr. X has overall control. By the transfer of shares to the daughters of Mr. Q and Mrs. P, the value was transferred, but not the power to act with it.

Besides the companies C1, C2 and C3, Deb BV and Sem Holding BV also own each 25,5% of the shares in C4. The other 49% are owned by a third party who owns the trademark rights. Thus the majority interest belongs to Deb BV and Sem Holding BV. The third party has no participation rights, it only has the rights on receiving 49% dividend over the profit of this company.

According to Mr. X there is definitely a difference in the way banks finance family firms nowadays compared to the time before the banking crisis of 2008. There is much more effort required of the family. If the bank finances a million euros, it is expected of the company that it also invests a minimum amount of €200 000 (20%). Before the crisis of 2008 this was completely different. Before 2008 there was no input required from the financing applicants. If the company could show a history of good profits and returns, no funding from the previous owner and successor was needed.

The type of financing that was used at Company C was the Dutch company succession facility. This facility can only be used if the previous owner of the company has no desire to cash out.

According to Mr. X there is a difference in financing between family and non-family firms because family firms can use the company succession facility and by that, keep the bank out of the firm, and non-family firms cannot. In case of non-family take-overs there is, in most cases, a need for external financing by for example a bank loan. An important factor in these cases is what the wishes are of the previous owner. Does he/she have the desire to reinvest in the company or not? Mr. X mentions a fellow company in which the former owner has a subordinated loan in the company which he sold to a third party outside the family. The rest of the financing demand was covered by the bank. The bank has sought to terminate the loan after six years unless the former owner would invest in the company again. A supervisory board was placed inside the company and the rent of the building towards the former owner had to be reduced. The negative spill in these acquisitions is often the bank. If you can keep them outside the business you can stay flexible and make your own decisions.

According to theory the previous owner of a family firm usually invest all or some of the money that is earned with the sale of the business back into the company. According to Mr. X it depends on the market in which the company is operating how much money the bank demands from the previous owner or successor to finance the succession process. Before the crisis of 2008 it was for business owners important to be able to show a good revenue model with an equity/solvability rate of 20%, if that was the case the banks would finance the entire amount of financing demand. Nowadays the equity/solvability rate should be 25-30% before banks are willing to invest. If this rate is not achievable, money must be provided by another party like the previous owner or the successor. But the problem is that the successor in most cases has no money to invest with.

The interest rate on a subordinated loan between the previous owner and the successor is established by negotiations between the two parties. In practice the interest rate from the banks are used with an interest margin which covers the risk due to the fact that the loan is subordinated. In most cases 6% is a reasonable interest rate.

On the question what the previous owner is willing to invest in the company after the succession Mr. X says that it depends on his pension arrangements and his commitment to the firm. Factors as where the company is sold to, family or a third party are of great importance in this decision. Most family firm owners like to see their company last for years and in those cases his pension plans and dividend are less significant.

Guaranteed credit provided by the government is commonly used in risky investments but it is also expensive. The interest of the business owners is aroused with the advantages of guaranteed credit, but if the price of this credit is mentioned they are often scared off. The disadvantages of guaranteed credit are that the repayment period is shorter than when you finance with a bank loan or subordinated loan of the previous owner. Furthermore, the government is watching your firm from a distance by looking at its financial statements and are more inclined to pull the plug when the company misses a payment. On the other hand, banks are more eager to finance in combination with guaranteed credit than without it.

According to Mr. X the disadvantages of financing with equity are that it is bound to the company. It is impossible to invest your money otherwise once it is reinvested. The previous owner could have made arrangements outside the company for a pension of 50%, and always had the intention to supplement this with the dividend of the family firm. With reinvesting the money made in the sale of the family firm, there is no possibility of dividend payments. The advantages of using equity as financing are; that you prevent the bank from entering the company, you keep more flexibility and independence, and you show a positive image towards the society because of the low leverage. This image is often looked at by for example investment firms, supplier and project managers.

Mr. X states that the risk of debt financing is to become overfunded. In this case the family firm can get in a situation where a bank or a third party is overruling the director or manager of the company. These parties can demand higher payments and place an expert from outside in the company who is tasked with watching and evaluating the management. Furthermore, if a family firm is going through tough times, banks are more likely to call for crisis management than before the crisis of 2008. An advantage of debt financing is if an expert is placed inside the company, it can give some new insights and show opportunities in the market. Another advantage is that its interest rate is lower than that of a subordinated loan, whereas the subordinated loan is more flexible in delaying the repayment period.

The tax advantage of debt still has a positive effect on the decision of business owners to choose debt financing, but Mr. X thinks this will change in the future. The Dutch government has the intention to change the tax system. It contemplated to change the tax law by lowering the corporate income tax. Furthermore, the amount of interest paid on debt capital will not be deductible from taxable profits. A company that is highly levered will pay a lot more corporate income tax than before because of this new tax law.

The owners of Company C state that their high aversion of risk and the loss of control play a part in the decision to use debt or equity as financing. Mr. X states that if the Dutch company succession facility did not exist, they would not have used debt financing to fund the succession process. In succession financing the bank will assess the company and the successor. The company gets grades for its management and operations. The successor is asked to give forecasts. If the successor has given forecasts in the past, the bank will check if those came true and thus were reliable. This whole whirligig was prevented at Company C by using the succession facility.

Factors as long-term commitment to the company, source of income of the family and the reputation of the company and thus the family name play an important role in financing decisions according to Mr. X. Family firm owners are in most cases extremely proud on their company. These entrepreneurs often stop at nothing to prevent their firm from going bankrupt because their family name is at stake. Furthermore, a lot attention is paid to business owners by their surroundings.

On the question if Company C searched for other forms of financing because of the banking crisis Mr. X answered yes. A truck had to be bought and in the past this financing would have been done by their principle banker. In this case Mr. X searched for the cheapest form of financing and got it from the ING in Amsterdam. The only thing this bank needed was the financials statement of the past year and the offer of the truck. According to Mr. X, because of the financial crisis banks ask for less information in case of small loans.

Mr. X states that, at Company C, there are no trust issues with the banks after the banking crisis of 2008 but the image of the bank employees is severely damaged. Nowadays companies are submitted much faster to special management within a bank. In case of special management, external specialist will enter the firm and tell you what to do. These specialists often have no knowledge of the firm and the entrepreneur. They will decide what it is worth to the bank to save the company. According Mr. X each bank is best to become a public authority.

Mr. X believes that the future will bring a system besides the banking system. Like the block chain initiative where virtual money is transferred and cards with credit are issued. This is direct accounting on each other’s customer card without involvement of banks. Mr. X is confident that in the future there will be a virtual financial world, because banks have not learned from their mistakes and scandals. The “me, myself and I” culture is still in place and quick enrichment is the standard.

Forms of pay-out to the former owner of the family firm are by interest on a loan or with profit preferred shares. The former owner can own one profit preferred share which incorporates a certain value with a dividend rate of for example 7%. This 7% of the nominal value will always be paid out regardless of the performance of the company. The preferred shareholder has to be paid before any payments of dividend go to the remaining shareholders.

Appendix 6: Interview with Company D

Interview	Company D
Date:	2 July 2015
Present:	Mr. W – partner at Company D
	Lotte Wolters - student at the University of Twente
Place:	Overdinkel

Company D is a consultancy firm that specializes in mergers and acquisitions which means that they help business owners with the selling and buying of companies. Consultancy in case of a transfer within the family is not common at Company D because as a consultancy firm they are experts in structuring, negotiating deals, managing the process etc. and those factors are often not necessary in the succession process within the family. With family firm succession the minimum value of the firm is of often used. Mr. W states that Company D does preform these taxations but it is less common. In most cases only taxation is necessary. If the value of the firm needs to be minimized, it is often the accountant of the firm that is responsible for the taxation and the guiding of the process.

Company D mergers and acquisitions takes care of the whole selling process which is started with the taxation of the firm. If the results of this taxation are of satisfaction to the business owner, the search for potential buyers can start. Company D will search for suitable buyers and goes into discussion with them. In a later stadium the financial statements will be researched and the negotiation of the contracts starts. If the buyer is accompanied by Company D, a financing memorandum is made and the consultancy firm searches for three to four banks which are compared where after the best choice is made.

According to Mr. W, Company D had no enormous decrease in clients that they expected after the banking crisis of 2008, however there was a small decline. The merger and acquisition needs of family firms however stayed stable. Mr. W states that there were no trust issues in the banks by his clients and it has never happened that because of trust issues a financing did not take place at Company D. However, many clients seriously talked about the scandals within the banks but none of them ended the relationship because of this. Mr. W did experience that when the ABN AMRO was taken over by the Deutsche Bank, a lot of Jewish entrepreneurs switched banks. They did not want to be a client of a German bank because of the world war.

Mr. W states that a lot has changed for the banks after the crisis of 2008. Their financing policy has become much stricter and they became more critical towards financing demands and business plans. Nowadays the entrepreneurs have to work much harder in order to get financed by a bank. But if the financing proposition is well founded, the bank would still be willing to finance. Entrepreneurs, who are not properly prepared and have a lousy business case, are unlikely to be financed by a bank. Mr. W states that at his firm a merger or acquisition has never been declined because the banks had no trust in it or because the proposition was not well structured and founded. Mr. W states that he knows firm owners where the financing request was declined but these entrepreneurs did not have a structured firm and a well-founded business case.

A factor that plays an important role in evaluating the financing request is the quality of this request. The financing and security structure in these reports are of great importance. Banks will critically look at the cash flows, future investments, profitability etc. These factors are thrown into a model that will at the bottom line give a positive or negative review. Furthermore, it is underestimated how busy account managers of a bank are. So if an account manager receives two credit applications that he has to evaluate with one looking untidy and disorganized while the other application has a nice booklet and is well calculated and founded, he will pick the latter. Company D has despite the crisis always been able to do the deals they wanted to do.

Mr. W is of the opinion that the crisis of 2008 had a positive effect on the banks in the sense of looking with a more critical eye towards financing requests. Before the crisis lousy investments were done in businesses that could not take a beating in tough times, luckily this has changed.

The type of financing that is used in family firm succession depends on the goal of the previous owner of the firm. If the owner has the goal to transfer the firm at minimum value, the proceeds are less significant and the tax paid has to be as low as possible. This means that the Dutch company succession facility is often used, where external financing is not necessary.

If the pension of the business owner depends on the company, he would rather cash out. Pension arrangements are of great importance in family firm succession. There are business owners that want to sell their company at maximum value to their children or a third party. They look much more professional at the succession process and in these cases external financing by a bank is more common. This has nothing to do with the size of the firm. Al family firms need financing in the succession process. The thing that matters most is the goal of the selling party, the buying party always wants to pay less and be more flexible. According to Mr. W the practice shows that the selling party in almost all cases want to minimize the value of the firm. But this also depends on how many children there are. If there are two brothers and one is taking over the firm, the minimizing of the value of the firm will be a shortcoming for one of the two brothers. In these cases Company D advises to intercept this shortcoming by supplementing the pay out, and to make everything transparent so everyone knows who is getting what.

The evaluation of business transactions by the tax authorities are not done beforehand in cases of transactions to a third party. In these cases the selling party will try to maximize the value of the firm and thus the selling price and the tax authorities will not miss out on any income. If the succession takes place within the family it is wise to let the tax authorities evaluate the case.

Mr. W states that he sees cases in which the former business owner co-finances the buy of the company. This happens within the family much more than toward third parties. Towards third parties it is only done if the obtaining of enough financing is difficult. This is necessary otherwise the selling party has to lower the selling price. In case of a subordinated loan the bank must be paid first before the repayment to the previous owner starts. These subordinated loans have higher interest rates because it is risk capital. The interest rate is created by mutual agreement. Company D advises to look at the interest banks are taking and adding a margin of approximately 2%.

Guaranteed credit is often used in succession financing, in particular the GO facility. In almost all cases the bank will try to fill a part of the loan with state guaranteed credit. The advantage of this credit is that it brings fewer risks for the banks because the state guarantees 50% of its credit and thus the bank is more eager to invest. The disadvantage of state guaranteed credit is that the company is less flexible and the repayment period is short. If it comes to the interest rate, state guaranteed credit is not expensive but it does have a high closing commission.

In family firm succession the bank will never finance 100% of the debt to the previous owner, so there is always equity in these types of financing. But it is not so common that external financing is needed. There are entrepreneurs that don't want the pressure of the monthly payments to the bank and thus will never choose bank financing. These entrepreneurs find it annoying that when the company performance is decreasing, they still have to pay the bank. In these cases the entrepreneur has to control the firm more on facts and figures and cash flow, this is not always a bad thing. It can often even lead to more conscious management and control. The former owner can always decide to pay off the bank and its pressure when this is needed but in practice this is very uncommon.

The disadvantages of equity financing are that it is less available. There are only a few companies that are able to pay a merger or acquisition 100% out of equity. Furthermore, the buying party is at risk because its wealth is invested in the firm and if the firm goes bankrupt, his money is gone. The advantage of equity financing is that the company is more flexible and there are no interest payments and repayments. If the money for the succession process is borrowed at the selling party, in most cases the parent(s), the question is how they will act if the business goes bankrupt and they lose their money. Thus it has al to do with the risk perspective and the equity the family has with regard to the value of the company.

The advantage of debt financing is that it is more available and there are thus more possibilities for buyers. The disadvantages are the pressure it has on the business with regard to interest and repayments. This pressure is not always a disadvantage, it can keep the management sharp on for example its debtors. Mr. W states that family firm owners like to keep the control of the firm into their own hands. They are much more conservative. The advantage of family firms is that they have a long term vision and commitment to the firm. Furthermore they are less levered and also less sensitive to changes in the environment. Mr. W thinks that the reputation of the family, the source of income, and the long term commitment to the company do not play a part in making financing decisions.

According to Mr. W there is no difference in financing policy of banks towards family or non-family firms. The banks will evaluate the business case and the financing request as the starting point in all cases. Banks will judge the management of the company. They will try to form a vision on the management by conversations and personal reviews.
Family firms owners are often more secretive about their company than non-family owners. Family firm owners will address their financial reserves first before they borrow money from a bank. The loan application therefore looks different than the application of a non-family firm.

Banks don’t like to finance management buy-in because of the high risks that come with it. In a management buy-out there is often a management in place, in these cases not a lot will change if the owner is bought out. While with a buy-in is a whole new management is placed into the firm who may not have much understanding of the company and the industry it operates in. The manager has no track record within the company, he does not know the people, the suppliers and the customers so there is a high risk of failure. If there is a gap in the financing, it can be filled by equity financing, a subordinated loan, private equity, investment firms etc. but then the required returns are much higher.

According to Wilber van Gerwen family firms did search for other forms of financing because of the banking crisis of 2008. This can be in the form of a seller’s loan, state guaranteed credit, company succession facility, private equity, informal investors, crowd funding etc.
A bank exists by lending money and giving interest on the savings account. Mr. W states that the functioning of banks will change enormously in the future, but that there will always be a need for funding and thus for banks. He nevertheless does not rule out that new initiatives will emerge on the financial market.

Forms of pay-out policy towards the former owner of the family firm depend on the form of financing that is used. If a subordinated loan is used, the previous owner will receive interest. If the former owner shill has shares in the company, he will receive dividend. Cumulative preferred shares are also used in practice but it is fiscally less attractive than a subordinated loan.

Appendix 7: Interview with Company E

Interview	Company E
Date:	2 July 2015
Present:	Mr. V – senior account manager corporate clients
	Lotte Wolters - student at the University of Twente
Place:	Overdinkel

According to Mr. V, banks are more critical towards clients and their financing requests. Furthermore, the long term results have become more important since the banking crisis of 2008. In the past historical results and a small forecast was enough to get financing from a bank, nowadays a well-founded business plan is needed with information about the financing needs and future prospects of the entrepreneur. Besides that banks expect more financial input, often 10% of the financing request, and commitment from the business owner. This can be done in the form of a surety. The equity and debt capital ratio of a firm is also an important factor in evaluating financing requests.

Banks are inherently risk evasive and will often use small private equity firms or government incentives like the GO facility and other forms of state guaranteed credit to finance risky projects like the succession of a family firm.

Mr. V states that Company E is keen on financing family firms because of their long term commitment to the company. In these types of businesses, financing is done to reap the benefits in the long term while non-family firms often undertake investments to enhance the profits of the firm on the short term. In most cases family firms have stable management teams which is also very important for banks to make financing decisions.

The advantage of family firm succession is that a large amount of the purchase price is financed by the previous owner by the use of a subordinated loan. According to Mr. V it is very rare that external financing is needed in family firm succession. Since the introduction of the Dutch company succession facility internal and external succession financing is uncommon unless the selling party wants to cash out.

If external financing is needed in succession financing the bank will look at wat is exactly bought by the new owner. In case of tangible fixed assets a mortgage loan or the pawning of the fixed assets is used as a form of financing. If the current assets and working capital need to be financed in succession, the debtors and stock that is present in the firm will act as a form of financing. Thus often a mortgage loan or a current account facility is used as financing. But in case of succession financing of goodwill, this will be financed by a loan with a repayment period of a maximum of five years. Goodwill financing is often done by blank loans because there are no tangible assets in goodwill. Because of the risk of these blank loans, the interest rate has a higher risk premium.

According to Mr. V there is a difference between the financing of family and non-family firms. Family firms have more consistence because of their long-term commitment and the risks for the bank are smaller. The previous owner is often willing to reinvest in the family firm and keep the buildings or machines under his own management. In the sale to a third party the business owner is more interested in cashing out and giving up the commitment to the firm, so in these cases there is more need for external financing. It is common that the previous owner reinvests in the firm even if it is sold to a third party. This will happen in cases that goodwill has to be financed and the bank is not willing to finance the entire amount of funding that is required. It will happen that the risk of this financing is spread among the previous owner, the successor, the bank, a leasing company, state guaranteed credit, or a private equity firm.

Company E rather finances a management buy-out because the management that is in place has already proven itself by showing positive results in the past. If the business owner that is leaving the firm reinvests into the company by a subordinated loan it is also a sign of trust in the management and a less risky financing decision for the bank. In case of a management buy-in there are a lot of unknown factors. Aspects that banks will assess are how well do they know this new manager, is there enough knowledge of the company, what is his vision of the company, is he going to make changes or will he lead the firm in the same way as the previous owner. All these factors are unknown and thus make the financing for banks more risky.

Company E assesses the risks that come with the financing. These risks are put into a model which gives a rating of the company with corresponding interest rates. These ratings are administered once a year. Hard and soft information and factors play a role in the risk assessment. The soft factors are for example the qualities of the entrepreneur, and the hard factors for example the financial statements.

According to Mr. V firm size is not of importance in the need of external succession financing. It depends more on the type of the company, what are their assets, are there enough securities for the bank. If a company relies on the sale of services, there are often no securities for the bank. In these cases financing is done with state guaranteed credit, financial input from the owner, and a short repayment period.

The interest rate on a subordinated loan is established by mutual agreement. In most cases the interest of the bank is taken with a margin of approximately 1%. Otherwise the tax authorities will see it as a donation. The interest rate between the selling party and a third party is much higher here a rate of 7-8% is normal.

Factors that play an important role in what the previous owner is willing to reinvest are the amount of money they wish to receive from the sale, the return on the investment, and the trust in the future proceeds of the firm.

The advantages of state guaranteed credit are that the bank is more likely to finance the succession process. There is a spread of the risks and in times of financial setbacks there is the possibility to stall the repayment period for a year. The disadvantage of state guaranteed credit is that it is expensive. The closing commission is approximately 4% over the total investment.

Mr. V states that the financing of succession or other forms of investments is changing from strictly bank funding to a combination of financing parties like the bank, the owner, the state with guaranteed credit, leasing companies, and private equity firms. This means that the part of the bank is becoming smaller in financing and in its place will take the form of a consultancy firm which brings together all the financing parties. The overall financing to the company will go through the bank.

The advantages of equity financing are lower financing costs which lead to more flexibility and a longer perseverance in difficult times. The disadvantage is that there is a low tax benefit of debt or, in cases of all equity financing, the whole tax benefit of debt is missed.

Furthermore, the risks of the financing are of total to the owner of the company. For example, if a client of the bank indicates that he cannot fulfil his obligations, the bank will search for the cause and help to recover the firm but they also demand more interest and a shorter repayment period due to the increased risk. Entrepreneurs, who have difficulties with paying the bank, get it even more difficult due to the extra interest and repayments to the bank. If a firm is equity financed, these problems will not emerge.

The advantage of debt financing is that if the cost of debt is lower than the return which can be achieved, it is a nice tool to earn money. Furthermore, part of the risk of the financing is for the bank. If an all equity firm goes bankrupt, the owner will lose all of his money, while if the company is 40% equity financed and 60% debt financed, the owner will be safe for 60% of his capital.

Mr. V states that a high aversion of risk and the losing of control are important factors in choosing the right amount of debt financing for the firm. If a firm is highly levered the bank will exert more control. In family firms control is more important than for non-family firms. The owner of a family firm finds it difficult to cope with the control of an external party because they see their firm as their child and their proud. Family firms are in most cases less levered than non-family firms.

The reputation of the family, their long-term commitment to the firm and their source of income plays, according to Mr. V, an important role in choosing financing options. He also states that the factor that there is an successor that is interested in the firm plays an important role for banks to approve of investment plans with a repayment period for example of 15 years. This loan will thus be paid off by the next generation.

In succession financing important assessment factors for a bank are the qualities of the successor, the results of the firm history and future, the industry in which it is operating, how sensitive the firm is to environmental factors, the financial statements, the profitability, the cash flow, the solvability, and the securities for the bank. Furthermore the requested investment must be in line with the history of the company. Mr. V states that the financing policy of Company E has become more critical since the crisis of 2008. Financing is based more on the strategy of the firm and its perspective of the future. In the past the securities and the history of the firm was of more importance.

Company E did see a decrease in the amount of financing requests. Overall, the number of loans has decreased enormously. This is mainly due to the economic downturn and with that the trust of the entrepreneurs in the economy. Regarding succession financing, the business owner could not sell his company for wat it was worth after the crisis of 2008. Before the crisis selling prices of 7-10 times the profit of the firm were normal, while banks only financed 5-6 times the profit. Nowadays the selling prices are normalized to 5-6 times the profit and the bank financing to 2-3 times the profit. What you see is that there is a gap between the selling price and the amount the bank is willing to invest. So there is more need for other forms of financing besides the bank. Due to the crisis banks are less willing to be at risk because in the past they have undertaken to much risky projects of which they are still feeling the consequences. According to Mr. V the interest rates that the banks take for investment projects will increase.

Mr. V states that family firms did search for alternative financing because of the crisis but this is mostly in internal financing.

The future will bring new financing alternatives according to Mr. V. The internet will become a greater source of investment providers. Company E has become too expensive to issue small loans of for example 50.000 euro. At Company E the ZRF is developed for entrepreneurs who need maximum funding of 1 million euros. The entrepreneur has to enter his business plan and financing request online. Within a few days this entrepreneur will get a positive or negative answer on his financing request.

According to Mr. V family firms have no trust issues towards banks after the crisis of 2008. He thinks that this is due to the fact that they rely less on debt financing and thus are less damaged by the crisis.

Appendix 8: Interview with Company F

Interview	Company F
Date:	8 July 2015
Present:	Mr. N – business controller
	Mr. U – senior business controller
	Lotte Wolters - student at the University of Twente
Place:	Almelo

Company F has production plants and storage facilities all over Europe. This gives them an enormous advantage in the field of distribution and logistics. Their network of companies is located ideally for transport by road, railway and water. Furthermore, they are always situated close to their clients which makes it possible to do just-in-time deliveries. Company F has two major components, (…..) products.

Mr. N started working for Company F in 2013 after working for KPMG for twelve years. Together with his colleague Mr. U, he is responsible for the monthly reports, financial reports for banks, and the contacts with the insurance companies. Mr. U started working for Company F in 2011 before that, he worked at Deloitte, KPMG, Timmerije BV, and thereafter an American listed company with an office in Netherlands.

In the year 2006 Mr. M bought his brother out of the company by the use of debt financing from the bank. The two brothers both owned 50% of the shares and after the takeover Mr. M became director and major shareholder of Company F. In case of family succession between father and son it is common that the succession process is financed by a subordinated loan from father, but this was not the case at Company F.

Mr. U states that in the period of 2010-2011 refinancing took place at the company. Because of the banking crisis the negotiations were much more formal and difficult compared to the time before 2008. The banks were looking for more securities and positioned themselves as risk evasive. According to Mr. U it also depends on the willingness of the banks involved. Since 2010 Company F switched from a consortium of ABN-AMRO and ING to a partnership with ING and Rabobank because this was financially speaking more interesting. The company did not search for other forms of financing due to the banking crisis. Mr. U has the opinion and the experience with banks that you have to be careful while dealing with them, because they will try to fool you in order to make more money.

According to Mr. N state guaranteed credit is never used in the financing of projects and the management buy-out. Since the crisis banks are more critical towards the value of land and buildings and using them as securities because the real estate market has collapsed. Nowadays the accounts receivables and inventories are used as basis of funding because they are current assets and thus faster to convert into cash.

Mr. U and Mr. N state that, since 2015, banks are more eager to lend money because there is a lot of money left. Not lending money is expensive because banks pay interest for putting it away at the European Central Bank while they could get a return on investment in the market.

Banks base financing decisions on their models where the information of a company is put in, and at the bottom line gives a positive or negative review. The interest rate is also based on this model. According to Mr. U and Mr. N the only way to find out if the interest rate is decent, is to compare it with other banks while keeping in mind that they can lower the interest rate just to get inside the company as financier.

According to Mr. U and Mr. N the disadvantages of financing with equity are that it is bound to the company. It is impossible to invest your money otherwise once it is reinvested. With reinvesting the money made in the sale of the family firm, there is no possibility of dividend payments. The advantages of using equity as financing are; that you prevent the bank from entering the company, you keep more flexibility and independence

Mr. N states that the risk of debt financing is the interference of special management when you are unable to make the repayments and interest payments. In this case you can get in a situation where a bank or a third party is overruling the director or manager of the company. An advantage of debt financing is if an expert is placed inside the company, it can give some new insights and show opportunities in the market. Another advantage is that its interest rate is lower and thus cheaper than equity financing.

Between 2010 and 2012 Company F had a tough couple of years because 300 employees had to be fired due to reorganizations. Non-profitable businesses were closed or sold. Before this restructuring the plans were submitted to the banks who gave their consent. During the restructuring process the banks blamed Company F for it costing too much money, while costs remained well within the budget. Due to this incident the relationship between Company F and the banks damaged. According to Mr. U it is like giving a child the consent to eat candy, and afterwards punish the child for eating it.

Mr. N and Mr. U state that factors as the avoidance of losing control and risk are no reasons for Company F for not using external financing. Also the factors as long-term commitment to the firm, family income, and the reputation of the family do not play any part in making financing decisions.

Despite the problems Company F faced with the banks in the period 2010-2012 there are no trust issues towards banks. After the reorganization the banks apologized for their behaviour and admitted that Company F made a wise choice.

Appendix 9: Interview with Company G

Interview	Company G
Date:	9 July 2015
Present:	Mr. T - manager
	Lotte Wolters - student at the University of Twente
Place:	Veenendaal

Mr. T has a degree Aviation Operation and studied General Management at Nyenrode Business University. After his study he worked at Baker Tilly Berk for three years before entering the family firm, Company G, of his father and uncle. Baker Tilly Berk is one of the larger accounting firms in the Netherlands, but they are not only active in the field of accountancy and tax. The company also provides services as legal advice, IT advisory, corporate finance, interim solutions, risk & performance management, grant audits, mergers and acquisitions advisory, and advise in business succession. Baker Tilly Berk provided mainly services for small and medium enterprises (SME). According to Mr. T the sale to a strategic partner was more common than succession within family firms in the three years of working for the accounting firm.

The interview with Mr. T focuses on the practical information he has gained at his former employer, Baker Tilly Berk and his current job as a manager at Company G.

According to Mr. T the effect of the banking crisis is that it has become more difficult to get financing from the bank. Before the crisis of 2008 the only thing that was needed for a financing request was a business plan. The only thing that was being looked at was the financial data of the company, if this was correct the loan was issued by the bank. Nowadays, this is not the case anymore. It is becoming increasingly important to be able to show a well-founded financing memorandum.

According to Mr. T, Baker Tilly Berk gave their clients the advice to consider crowd funding as a financing option. The disadvantage of crowd funding is that the interest rate is higher than the bank. Most of the financing in cases of succession and acquisitions is done by banks.

The most common forms of financing in succession were subordinated loans from father to child and the company succession facility. Mr. T states that it depends on the family firm and the wishes of the previous owner what he or she is willing to reinvest in the firm in the form of a subordinated loan. Baker Tilly Berk handles the entire acquisition or succession process of family businesses. They specialize in valuations of companies, also outside the situation of succession and acquisition financing.

Mr. T states that family firms are generally speaking healthy firms who can keep the banks interference outside their company. Because family firms are low leveraged firms, banks are more eager to finance succession or acquisition processes.

Generally speaking banks rather do business with companies where a management buy-out occurs instead of a management buy-in. According to Mr. T there is a higher success rate in management buy-outs that buy-ins. Though it may in certain cases concern a buy-in of a management that is an expert on the companies industry.

Mr. T states that there is, in terms of products, no difference between bank financing in family firms and non-family firms. However, there is a difference in the area of risks, terms, and conditions. Banks generally are more confident in family businesses because of their long-term commitment to the firm and long-term vision.

Mr. T states that there are a lot of trust issues between family firms and banks due to the financial crisis of 2008. Many clients of Baker Tilly Berk bought derivatives from banks. The problem mainly concerns the sale of so-called interest rate swaps. These are financial products to 'secure' the variable interest rate on loans. If the interest rate exceeds the agreed interest rate, the bank will pay the difference to the company. But because the interest rate was and is very low, many of these products have a negative value. This puts entrepreneurs in financial trouble. Mr. T states that many bank employees had no idea what they were selling to their clients. Because of this and the complete banking crisis of 2008 the image of the banks has severely damaged.

The advantage of equity financing is that the company can stay flexible, there are fewer risks and no obligated repayments. Mr. T sees debt financing as the last resort in need of financing. Always keep the banks interference out of your company if you are able to.