

The complexities of generational change

Whether within the family or in society at large, relations between the generations are all about give and take. Estate distribution and business succession are increasingly important aspects of this.

Karin Schefer



Educational expansion, new technologies and the resulting productivity gains played a key role in increasing prosperity in the Western industrialized states in the second half of the 20th century. Not only has the pace of wealth accumulation greatly accelerated but more and more people are enjoying the benefits - and passing these assets on to their descendants. According to estimates, some CHF 100 billion are inherited in Switzerland every year. At the same time the owners of numerous companies are set to hand over the reins to the next generation. This is one of the most critical phases in the life of a (family) company and seriously affects a wide circle of people.

Yet while capital accumulation by private individuals and companies reaches unprecedented heights, government debt and the inherited liabilities of society as a whole are set to have a negative impact on the efforts of future generations to make a good life for themselves. This is

the result of the complex relationship of one generation to the next, which is now no longer financially in balance due to demographic change.

Three-generation families

A generation is generally understood to be the difference in age between parents and their offspring. The average age gap between mothers and children is about 30 years - a figure that has hardly changed since 1950. By contrast, life expectancy in Switzerland rose by about 36 years in the 20th century and now stands at 83 years for women and 77 for men. The life-spans of the various generations in a family are thus increasingly overlapping and three-generation families becoming increasingly common. However, the nature of the relationships within families of this kind has changed: it is now very rare to find all three generations living under one roof. This has greatly accelerated the shift from the family to the state as the main provider of care for the elderly.

Just as sharp as the rise in the number of older people as a result of increased life expectancy has been the decline in the number of younger people due to a drop in the birth rate. The birth rate in Switzerland has fallen from 2.69 in the baby-boom years following World War II to 1.48 today. Not enough children are being born to maintain current population levels. Assuming that life expectancy and the death rate

remain constant, every woman would need to have an average of 2.1 children to ensure that each one has a daughter who will reach child-bearing age.

Giving and taking

The roles, rights and duties which generations impose on each other have always altered as life progresses (see table). As children, we are recipients of support until we reach adulthood, whereupon we primarily become income generators before retiring and returning to our role as recipients. Depending upon their financial circumstances, however, the post-retirement generation will also make gifts and legacies at the private level and often help to look after their grandchildren. The real flow of goods and

services between the generations follows a largely fixed pattern: the national product created by the working population has to sustain both the younger generation and, at least to some extent, pensioners. The best example of the contract between society's different generations is the AHV's pay-as-you-go financing system: its pension payments are financed by on-going contributions from workers and by public (tax) revenues. The risk with this system is the notorious financing gap that will emerge in the event of a sustained shift in the ratio of workers to pensioners. According to official statistics there will be just 1.6 workers for each pensioner by 2040 (today the figure is 3:1), which will sorely test the contract.

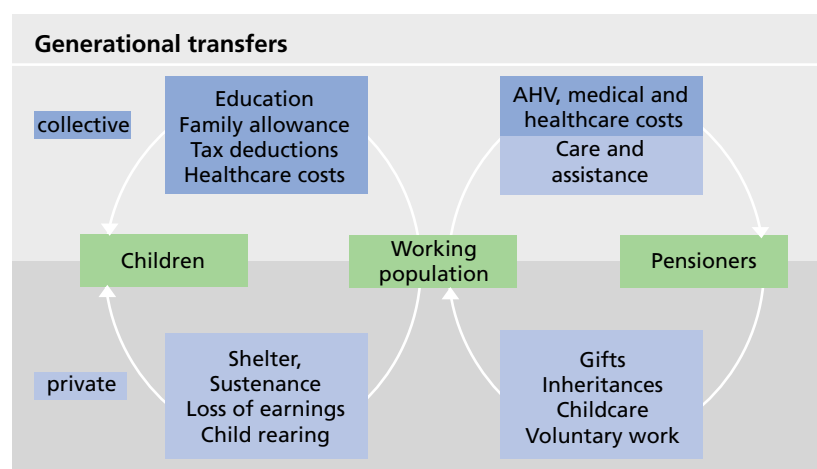
High transfers between the generations



The financing of public healthcare is also based in part on the idea of solidarity – society working together to help the individual. The pact between the generations rests on the fact that children by their very nature do not make any contributions themselves, while older people on average consume an inordinately large amount of medical services in relation to their premium payments. As a result of the ageing of the population, the pay-as-you-go approach will further increase the burden on those in work as more of their funds are transferred to the older generation in this sector too. Furthermore, the working generation is personally helping to look after and pay for the care of their aged dependants.

Cost of raising children: CHF 70 billion

Most of the expense of raising children is borne privately, with tax revenue accounting for just a small fraction of the cost. Raising children is a costly endeavour, as proven by figures from the Federal Office for Social Insurance relating to 1995. Projected to the year 2001 the direct cost of raising a child from birth to his or her 20th birthday for a household with an average income is about CHF 360,000, with every additional child costing about CHF 160,000. For the whole of Switzerland, these costs add up to some CHF 23 billion a year. And they even do not include the lost income resulting from the parents' reduced employment; according to the same source this would add at least a further CHF 25 billion a year. Of the CHF 48 billion in childcare costs borne privately, state contributions account for about one-sixth, mostly in the form of family allowance and tax deductions. State spending on education as an additional social transfer to the younger



generation comes to CHF 22 billion a year, which makes annual spending on raising children a total of CHF 70 billion or around one-sixth of the country's GDP.

Generational imbalance

Educational expansion in the last century not only greatly advanced the ideal of equal opportunity but was also the vital factor enabling productivity to improve and prosperity to increase. As a result, today's pensioners will leave behind not only private wealth but also a rich collective legacy of knowledge, technology, public infrastructure and other benefits. It is difficult to put a value on such social assets; but the "return" on the investment will benefit generations to come by providing a firm basis for further improvements in living standards.

The other side of the coin are the liabilities that coming generations will have to bear, including the high government debt, which currently stands at 51% of GDP. This snapshot, however, paints a less than clear picture. Generational accounting – a relatively new instrument developed for Switzerland by the State Secretariat for Economic Affairs (seco) – thus goes even further, by also factoring in the long-term impli-

cations of a changing population structure on state finances, setting all the claims and liabilities of current and future generations against one another. The clear shift towards a larger proportion of older generations will be reflected in higher spending on pensions and increased healthcare, homecare and disability costs, which will put further strain on the state coffers. Future generations will have to bear the principal burden, either by paying higher taxes and social security contributions or – if fiscal policy remains the same – accepting lower levels of social security entitlements. The first results of generational accounting – taking 1997 as the reference year – thus show explicit net indebtedness of 36% of GDP (government debt minus assets held in the social security system) plus an implicit burden of 39% of GDP, which increases the "sustainability gap", as it is known, to 75% of GDP.

Inheriting an estate in old age

At the individual level there are record-high asset transfers in store for the next generation. About CHF 100 billion are passed from one generation to another every year. Of the private assets which have grown so rapidly in the past

few decades, around one half are owned by pensioners, although the latter represent only one-fifth of the population as a whole. There are two main reasons for this: firstly, personal savings peak at the end of the individual's working life. The consumption of accumulated capital that might be expected to occur during this period of people's lives is being delayed as a result of incoming pension payments and established savings habits. Secondly, it is at this stage of your life that you inherit the estates of the generations that came before you. For, given increased life expectancy, you often do not receive inheritances until just before you enter retirement yourself.

In this situation, inheritance planning becomes a major issue – especially within non-traditional family set-ups. If you do not make provision in good time, your estate will be distributed in accordance with inheritance law; and legal succession is governed strictly by the degree of family relationship. Domestic partners, for instance, are unable to make a claim. To ensure that your partner is awarded any share of your estate, you must make appropriate arrangements by means of a

last will and testament. Only by drawing up a will or a contract of inheritance can you determine what share of your estate goes to whom, subject to the legally prescribed minimum shares to which close relatives are entitled. Other ways of benefiting specific individuals include making gifts while you are alive or setting up simple companies. In addition, individual succession planning will help to optimize tax, pension and real-estate aspects. Particularly when it comes to real estate, which in terms of value accounts for about half of the assets held by pensioners (see chart), it is often difficult to plan and implement succession, especially if joint heirs have differing ideas about what to do with the property.

Wanted: person to take on family company

The handover from one generation to the next is even more complex in business – and not just from the point of view of inheritance law. If a company is family-owned, it is usually the family's biggest asset and a number of heirs may register

claims to a part of it. Many company owners see succession arrangements as an important task. They start thinking about the issue in good time and try to avoid conflicts by means of succession planning arranged specifically with the company in mind. If you take due account of the legal, financial, fiscal

Succession must be well planned

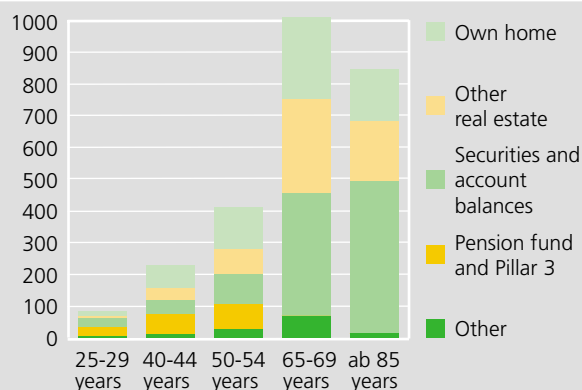
and – not least – human aspects of succession, you can often pass on a competitive company with its operational expertise intact and without having to shed any jobs. Yet ensuring a smooth transition is far from easy: as the Institut für Mittelstandsforschung has shown with reference to Germany, about 8% of companies whose owner is about to retire have to be shut down due to the lack of a successor.

Many family-owned companies will be passed from one generation to another in the next few years: 18% of all family-owned companies in Germany will be transferred to a successor or – if this is unsuccessful – wound up between 1999 and 2004. The figures are likely to be about the same for Switzerland. It is estimated that around 80% of Switzerland's more than 400,000 firms are in family hands. A representative survey of SMEs in German-speaking Switzerland in 1996 established that the average age of company owners was 54. Only 10% of company owners were between the ages of 25 and 40, compared with 27% who were over 60.

Handing over the reins is one of the most difficult stages in a company's existence. Many company owners have difficulty planning their own succession and some put off making serious arrangements until later.

Assets in the life cycle

Net assets by age category in CHF 1000 (Canton of Zurich)



Source: Statistical Office of the Canton of Zurich, VZ, calculations by UBS

The amount and structure of average assets in selected age groups were integrated from various sources (basis: component statistics of the Canton of Zurich, 1997; real estate adjusted to current values; total pension fund, vested benefit and Pillar 3a balances from 1996 distributed among age groups using a special calculation model).

Surrendering control of your life's work is not only a dramatic event for owners and their families but also a wrench for the company, its employees and management as well as clients and suppliers. Making effective arrangements for your succession in good time prevents unnecessary friction during the handover and also ensures continuity.

Buddenbrooks syndrome in real life

Of the numerous company successions on the cards in the coming years a large percentage will be resolved within the family – in Germany the figure will be over 40% (see table). This is generally the solution favoured by company owners. However, this outcome cannot be taken for granted, especially over a number of generations and particularly as the trend towards smaller families means that there are fewer and fewer successors to choose from. The way a family fortune – the company set up by the great-grandfather – was built up through the hard work and successful entrepreneurship of the grandfather, little more than consolidated by the third generation and frittered away by the grandchild was the subject of Thomas Mann's literary masterpiece "Buddenbrooks – The Decline of a Family".

The most common succession models for family companies

Form of transfer	in %
– to family members	42%
– to managers within the company	13%
– to external managers	15%
– sale	22%
– closure due to lack of successor	8%
Total transfers	100%

Source: IfM Bonn, 1999; companies with annual sales/revenues > DEM 100,000

Swiss family-owned companies face handover to a new generation

According to our own survey carried out in June among 200 family-owned businesses in the manufacturing and construction sectors, one firm in three is due to hand over the reins within the next 5 years (see chart). For many of them this is nothing new, as just under 60% of the family-owned businesses in our sample are already in at least their third generation, with 26% in their fourth. The companies are thus quite old. The average year of foundation was 1920, with three out of ten companies established before 1900. By contrast, younger firms are underrepresented in our sample.

The more revealing were the answers given about succession planning. Of those firms whose owners are due to step down within the next five years, 18% have already made detailed succession arrangements.

29% have reached agreement in principle but have to make some more detailed preparations. The succession arrangements of just under half of the companies surveyed are still at the planning stage. ■

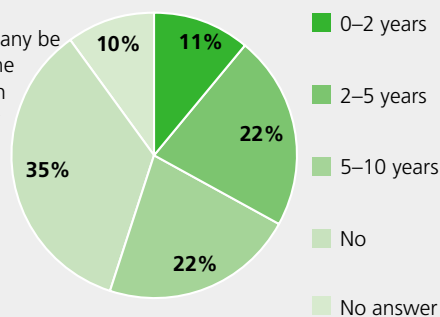
When will the next generation take over?

Proportion of companies in %

Question:

Will your company be passed on to the next generation in the next few years?

If so, in how many years?



Source: UBS survey June 2002

Buddenbrooks syndrome – the establishment, accumulation, consolidation and dissolution of wealth – may be the stuff of fiction, but it has its basis in reality. According to various sources, less than 10% of all family companies make it to the fourth generation. Another study shows that only 17% of companies enjoyed significantly positive sales and earnings growth for more than one year after having been handed over to a son or daughter. 31% stagnated as a result and 52% posted negative results. It is therefore advisable to consider other possibilities early on. There is an extremely wide range of options available, which – depending upon the size and market presence of the company – can include external management with family control, (partial) sale, a management buyout, merger or stock-market flotation. There are no magic formulas here; only a solution

tailored to the individual situation can provide any guarantee of success.

Natural but fascinating

While the shift from one generation to another is a natural process, the implications in times of demographic change and increasing prosperity are extremely complex. It involves social, family, macroeconomic, company-specific and highly private issues more than almost any other aspect of human interaction, and raises at least as many questions as it solves. Everyone is affected at different levels and forced to think about it throughout his or her life. Yet this is precisely why it is so fascinating. ■

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Electricity market deregulation made to measure

A reliable and affordable electricity supply is key to corporate competitiveness. But opening up the Swiss electricity market is also important from an economic policy perspective.

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In 1997 the EU enacted its guidelines on the creation of a single European market for electricity. It did so with the aim of making the best possible use of more favourably priced resources in a liberalized electricity market. While the recent EU summit in Barcelona reduced the pace of deregulation slightly, it did not stray from the fundamental goal of an open European market in electricity. Germany, the United Kingdom, Norway, Sweden and Finland have already gone beyond the partial liberalization targets set for 2003 by the EU, entirely opening up their markets with a view to creating a completely deregulated and integrated single EU market.

Switzerland's place in the European electricity network

As a hub and important player on the European electricity market, Switzerland cannot and should not avoid this trend. The disadvantages for the electricity sector and for the competitiveness of Swiss exporters as a whole would be too great. The Swiss elec-

tricity industry is heavily involved in trading electricity with other countries, notably France, Germany and Italy. With imports of 58 TWh (1TWh = 10^{12} Watt-hour) and exports of 68 TWh, Switzerland produced an export surplus of 10 TWh in 2001 – over three times the amount of electricity consumed by the City of Zurich in one year. With its hydroelectric storage plants, which can be rapidly connected and disconnected, Switzerland also performs an important role in balancing out supply and demand in the European grid. The pumped storage system allows it to convert cheaper base-load into valuable peakload energy.

Households in Switzerland pay just under CHF 0.20 per kWh of electricity on average, while the business rate is about CHF 0.145. Compared with average figures for the EU, household rates are about the same but corporate rates are relatively high. Market liberalization began in Switzerland

before legislators became involved, and major Swiss clients negotiated better supply contracts long ago. It was not until 15 December 2000 that the Swiss Parliament passed the Electricity Market Law (EML), which allows for the gradual deregulation of the market. Opposition to this decree came primarily from the trade unions, which called for a referendum; the people will thus have the last word at the ballot box on 22 September 2002. To increase acceptance for the EML, the Federal Council departed from its normal practice and

issued the respective ordinance, which is needed for the law to be implemented, before the referendum. This had been preceded by heated discussions between industry, the cantons, consumer organizations, environmental associations and the electricity sector. The effort paid off, as the bill now enjoys wider support.

Radical changes in the electricity market

Today more than 1,000 power stations provide Switzerland with electrical energy. They differ substantially in terms of size, operational and organizational structure and legal form. In some cantons and towns power stations are responsible for the entire supply chain, while in others the functions of electricity generation, production and distribution are each performed by different firms. The 40 largest suppliers meet about 60% of electricity demand, the smallest 500 only 10%. Compared

with other European firms, however, even the so-called “big companies” are small: the total sales of all Swiss power stations equal only about 15% of the figure for the French firm EDF or Italy's Enel. Liberalization will alter the structure of the Swiss electricity market. Companies such as Axpo, Swiss City Power, Avenis and Watt Suisse AG, have been amongst the first to form alliances with domestic and foreign partners in response to the need to counter cost and productivity pressure. Under the EML a company must be set up within three years to operate the

Liberalization brings lower prices



Swiss transmission grid. Two firms, currently majority owned by the seven network grid companies, have already been established: Swissgrid (CKW, EGL, EWZ and NOK) and Schweizerische Netzgesellschaft SNG (Atel, BKW and EOS).

Thanks to its clear regulatory framework and the reciprocal arrangements with Europe, the Electricity Market Law ensures that Switzerland will continue to play an important role in the international electricity market. Local power stations can from the start buy some of their electricity cheaply on the open market. Smaller consumers will also benefit from liberalization – even before the market is completely opened up in six years' time. SMEs will be able to freely choose their suppliers and also negotiate other discounts by pooling their purchasing requirements. Given that household electricity prices in Switzerland are not so far above the European average as those for large corporate consumers, however, a sharp reduction in charges here is not anticipated.

There is much greater price-cutting potential in the industrial and services sectors. In Germany these have enjoyed discounts of 18% on average since 1998 despite an increase in their tax burden. In the absence of reliable figures, it is impossible to say for sure by how much Swiss corporate rates have already come down as a result of previously negotiated discounts. However, the EML encourages price reductions by obliging companies to publish their charges for electricity interconnection services, by prohibiting monopoly rents on grids that have already been amortized and by obliging companies to pass on to consumers the price benefits resulting from the deregulation of the market. The current price differentials between the

Key points of electricity market deregulation

- Unbundling the sector, i.e. a clear division (for accounting purposes) between the generation, transmission, distribution and thus price of energy and the national grid.
- Market prices ensure greater competition in the electricity market.
- Supply monopolies are dismantled; the only company to maintain a monopoly is in the high-voltage segment as a result of the merger combining the previous owners of the transmission grid into a private, national transmission grid company.
- Duty of grid owners to provide interconnection services guarantees consumers non-discriminatory grid access at clear prices.
- Supply guarantees thanks to obligation on grid operators with regard to connections, engineering, supply and settlement.
- Market deregulation in three stages: once the EML enters into force, free market access will be granted to final consumers whose annual consumption exceeds 20 GWh and to final distributors in respect of 20% of their annual sales. After three years free market access will be granted to consumers whose annual consumption exceeds 10 GWh and to distributors in respect of 40% of their sales. After six years the market will be fully deregulated.
- During the transition phase no increase in interconnection charges, over which the grid has a monopoly, is permitted. Price increases are only sanctioned in highly exceptional circumstances.
- To reduce interconnection charges in the interest of consumers in the medium term, efficiency comparisons are to be made by an arbitration commission on the basis of international data. Where it finds inefficiencies and price misuse, the commission can order price reductions and refunds to consumers.
- The need for clear accounting, the opportunity to change electricity providers simply and without charge and provisions for the identification of the origin of the electricity and the generation method used ensure a high degree of transparency. ■

regions and the cantons should also narrow gradually.

Economic policy dimension

The referendum to be held on 22 September 2002 is about more than just electricity market liberalization. It is about whether the market should be deregulated on the basis of clear-cut rules or 'the law of the jungle'. For the alternative would be a bewildering proliferation of price structures dependent on the strength of the individual electricity consumer. This is precisely why we should not compare with the much-cited bad example of California: the liberalization of the market there was based on inadequate legislation (restrictive price regulations, ban on long-term supply contracts, laborious authorization procedures for badly needed new power stations).

In addition, there was an unexpectedly sharp increase in electricity demand and problems with grid capacity.

Above all the referendum against the Electricity Market Law will be interpreted as a plebiscite on deregulation per se and a verdict on the fundamental issue of whether to reverse the important restructuring processes aimed at improving the country's competitiveness and prosperity. It is this economic policy dimension that lends particular importance to what might at first sight appear to be no more than a normal vote on a technical framework law. ■

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