

Research

The Grey Wave - The Global SME Succession Crisis & the case of Japan

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The Worldwide Succession Crisis

It is no news that around the world, birth rates are plummeting and demographics are shifting. The “baby boomer” generation (those born between 1946 and 1964) has already reached or is nearing retirement age, and many are calling it “the grey wave.” For Small to Medium Enterprises (SMEs) without heirs, this translates to a succession crisis for developed economies with low birth rates and aging demographics.

- **France:** 700,000 companies will need to find new leadership in the next decade
- **Germany:** 626,000 companies requiring succession solutions by 2027.
- **United States:** 2.9 million U.S. businesses with owners over 55
- **South Korea:** 210,000+ SMEs are estimated to still lack successors
- **Japan:** projected to have about 1.27 million SMEs shut down by 2030 due to a lack of a succession plan.

Along with this “grey wave”, birth rates in these countries (and most developed economies) are plummeting, meaning that there are fewer potential successors within the younger generations, especially for traditional businesses that have passed down their enterprise through generations. Societal shifts and economic needs are also affecting said successions; most young professionals are moving to urban centers and choosing to follow corporate careers or tech startups rather than taking over a family business with its own set of risks. With the digital economy on the rise, the complexity of the global market, and financial insecurity, young professionals might view the inheritance and management of SMEs as a riskier and less appealing alternative to other career paths. Additionally, certain regulatory and bureaucratic processes tend to hinder the succession process by making it more complex and costly than it needs to be.

This trend is concerning for various reasons. SMEs represent approximately 90% of businesses worldwide and play a crucial role in driving economic growth, creating jobs, fostering innovation, facilitating international trade, ensuring resilient supply chains, and promoting balanced regional development. According to the OECD, SMEs account for up to 60% of value added in OECD countries and employ roughly two out of three workers. However, many SMEs face succession failures (lack of business heirs or a sustainable succession plan), leading to firm closures and economic losses, especially in aging societies. Although some SMEs successfully sell their enterprise when lacking an heir, in most cases, owners can't find a buyer, which forces the business to close up and disappear for good.

1.27 MILLION SMES IN JAPAN ARE PROJECTED TO SHUT DOWN BY 2030 DUE TO LACK OF SUCCESSORS

The Case of Japan

SMEs are the backbone of almost every developed economy. Japan is no exception, since its SMEs comprise nearly 99.7% of all registered businesses and employ over 70% of the country's labor force. However, the future of many of these businesses is grim. Japan's national surveys estimate that nearly **60% of SME owners are aged 60 or above**, and nearly half lack a designated or willing successor. Governmental agencies and other stakeholders have taken various measures to address the succession gap:

- **The Ministry of Economy, Trade and Industry (METI):** introduced financial subsidies, inheritance tax incentives, and SME succession matching platforms.
- **Private Sector:** Various private actors have introduced technological solutions that optimize and accelerate the matchmaking process, such as AI-based platforms that pair retiring business owners with potential successors or buyers.
- **Mukoyōshi:** This traditional Japanese practice involves adopting an adult male (typically a son-in-law or loyal employee) into the family to maintain both the household and business lineage.

However, the succession crisis's complexity has impeded any measures from achieving scalable success.

Why is it riddled with complexity?

On one hand, both government and private stakeholder initiatives typically treat succession as a logistical issue and often sideline the familial, emotional, and cultural factors that are involved in business succession, particularly in Japan, where familial ties are of extreme importance. Succession in Japan often involves personal or familial identity, a craftsmanship that is deeply embedded in a family's reputation, which has been cultivated for generations. A succession plan that does not honor that identity will likely be rejected.

A personal and case-by-case strategy would be ideal, but it comes with its own complexities due to a lack of administrative manpower. Digitalization efforts can certainly reduce purely logistical challenges, but many of these cases require a more human and personal approach. Moreover, these solutions often have very limited outreach and are plagued by administrative inefficiencies. Many SMEs who could potentially utilize said initiatives or programs often fall through the cracks simply because they are unaware of these solutions.

Is foreign acquisition an option?

Although foreign acquisition is a plausible alternative, it often faces its own set of challenges when facing Japan's succession culture. Since identity is important in Japan, there will likely be apprehension when a foreigner, with little connection or knowledge of a local SME's culture and identity, attempts to acquire a local SME, regardless of how severe the succession crisis may seem. Moreover, Japan in general has been hesitant to integrate foreign entrepreneurs into its SME ecosystem, despite their potential to revitalize businesses through acquisition or investment. Linguistic, cultural, and regulatory barriers make foreigners a less ideal alternative for a succession plan.

Mukoyōshi - A traditional but highly patriarchal practice

This culturally embedded practice of adopting a male heir (whether through a son-in-law or loyal employee) offers a viable and culturally sound solution. However, it only works in isolated cases, making it practically an unscalable strategy to apply nationwide or integrate into new succession strategies. Secondly, it tends to emphasize very old-school patriarchal norms. By not including potential female heirs in the equation, the pool of potential successors becomes even narrower. Not to mention that a highly-qualified female successor (whether in the family or amongst the company's employees) would not even be considered simply because of traditional gender-norms. Moreover, policymakers looking to balance SME continuity goals and maintain gender inclusive programs and incentives will need to develop more gender neutral startegies and institutional innovations to confront this nationwide dilemma.

The Employee Ownership Solution

The Employee Ownership Solution is a succession strategy that is taking flight in academic and business circles in the United States and several European countries. The employee Succession model is essentially a way for a business owner to exit the business by transferring ownership and control to employees, instead of selling to family members, competitors, or private equity. It is considered a viable mechanism for SME owners nearing retirement who lack family successors or suitable external buyers. Such models can preserve continuity, maintain clients, avoid closure, and help retain jobs, especially in cases where traditional successors are scarce. Moreover, it is a solution that can take place all at once or gradually, and directly or through an intermediary vehicle (via a trust, cooperative, or holding company).

It is a model being implemented in the United States to preserve various SMEs across various states and industries in the United States. Moreover, different companies and non-profits structure their employee ownership alternatives to specifically target the most pressing issues in employee succession: the lack of financial stability and access to capital. Most employees might be interested in purchasing the business, but they usually lack the capital to take it over. In these cases, an intermediary vehicle or third party can step in through a transaction structure that includes no upfront cost to employees and gradually shift toward majority employee ownership. This model allows companies to stabilize and grow during the upheaval of the owner's retirement without sacrificing the business's core elements, such as its employees, client relationships, brand reputation, and company identity & values.

Main forms of employee succession

- **Employee Buyout (EBO)**

- Employees purchase the company, often with:
 - Bank loans
 - Seller financing (owner leaves capital in the firm)
 - Public or development-bank guarantees
- Common in: Continental Europe
- Risk: Requires strong cash flow and financial structuring

- **ESOP-based succession (Employee Stock Ownership Plan)**

- Involves a trust or plan that:
 - Borrows money to buy the owner's shares
 - Repays the loan using future company profits
 - Allocates shares to employees over time
- Common in: US, increasingly in Europe
- Academic view: Strong for succession if governance is well designed

- **Employee Ownership Trust (EOT)**
 - A trust that:
 - Acquires a controlling stake (often 51–100%)
 - Holds shares on behalf of all employees
 - Pays the former owner over time
 - Common in: UK (post-2014), studied as a policy success
 - Key feature: Employees usually do not buy shares individually
- **Worker cooperative succession**
 - The company converts into:
 - A cooperative owned and governed by workers
 - One-member-one-vote governance
 - Common in: Spain (Mondragón), Italy, France
 - Strong in: Manufacturing, services, social economy firms

Policy and Regional Studies - US, UK and EU

US - Scaling with broader policy and ecosystem support

- Employee ownership is emerging as a mainstream succession option for retiring business owners facing the “Silver Tsunami” of retirements. Via ESOPs, cooperatives, or trusts, employee succession is becoming a viable exit path that preserves businesses and local jobs.
- **Harvard Business School**’s researchers explicitly frame employee ownership as a solution to succession challenges – preserving businesses, jobs, and local economies in the face of mass retirements (“silver tsunami”) and have held academic conferences on these questions
- The non-profit organization **Project Equity** helps owners across states and industries transition to employee ownership, aiming to retain companies locally and build long-term wealth for workers.

UK Experience with Employee Ownership Trusts (EOTs)

- The UK’s EOT model, introduced in 2014 and now widely studied, is often held up as a policy-driven response to the succession problem. It allows owners to sell their business to a trust holding shares for employees, offering price realization for owners and ownership continuity for companies.
- Studies indicate many SME owners now view EOTs as a credible exit option that protects jobs.

European Research on ESOP/EOT Models

- Research institutes in Europe (e.g., the Institute for Economic Democracy) note that ESOP-like vehicles can preserve local economic value, jobs, and community embeddedness compared to external sales that may lead to relocation or asset stripping.
- They also emphasize policy support, incentives, and legislation as critical to adoption.

Empirical Patterns Across SMEs

- OECD and related reports on business transfers highlight that traditional family succession is declining and non-family options (including employee buy-outs) are increasing in importance, especially as educational and career options pull descendants away from family firms.

Could the employee succession model be an option for Japan's SME environment?

Succession to internal personnel is explicitly recognized as a non-family, internal successor option in national SME succession studies. Under Japan's "**Law on Smooth Succession of SME Management**" (経営承継円滑化法), it's the core succession law, the government focuses on supporting various successor types, including employees:

- It provides tax relief frameworks (e.g., gift/inheritance tax deferral/exemption for SME stock transfers to successors) for family and internal succession.
- It also facilitates financial assistance and court/legal exceptions to streamline succession transactions.

The employee succession model could help maintain the original identity and legacy of the SME, which is essential for business succession in Japan. Business and economic research highlights that employee succession could help solve the market failure of the "grey wave" and increase business survival rates. Most importantly, this model can help preserve intangible capital, such as developed employees, client relationships, and keep business culture intact. In Japan's particular case, this model could help maintain the original identity and legacy of an SME. Additionally, it is important to highlight that the employee succession model may offer a more gender-neutral alternative to the Mukoyoshi practice, all while maintaining the important focal point of continuity and identity.

Challenges

There are a few structural reasons employee ownership hasn't yet become a major policy category like it is in the U.S. or U.K. (e.g., EOTs):

- **M&A Is Still the Government's Primary Succession Focus**
 - Governments have heavily promoted third-party M&A and matching centers to find buyers for succession problems — the number of SME M&A deals has grown sharply in recent years.
 - This has meant employee succession has been perceived as one of several options rather than the main taxiway for succession.
- **Cultural and Financial Barriers**
 - Many SME owners in Japan still prefer traditional successors (children or long-serving employees) but lack formal financial vehicles like ESOPs to facilitate internal buyouts.
 - Domestic banks and advisors haven't historically developed robust financing markets for employee buy-outs, unlike in the U.S./U.K., which makes it harder to implement employee ownership at scale.

Opportunities for Foreign Entities (Companies or Investors) Facing M&A Challenges

As beforementioned, foreign entities interested in acquiring or sustaining SMEs in Japan often cite M&A frictions (such as cultural differences) as barriers. The employee ownership model could be leveraged by foreign entities to ease their entry path.

Partnering Through Employee-Facilitated Transfers

Some foreign models are now entering Japan to support employee buy-outs by purchasing the SME outright, then retaining employees with an equity stake, and later spreading employee ownership over many years.

This model essentially blends third-party acquisition with employee ownership succession:

- The foreign investor buys the company and gives a share to the employees
- Meanwhile, employees gain long-term ownership incentives

Such hybrid structures may give a legally and culturally easier path for foreign buyers who struggle with traditional Japanese M&A (especially when owners refuse to sell to outsiders). From a practical standpoint, employee succession models can help address key challenges that foreign acquirers face:

- **Smooth Integration and Retention**
 - Employees with ownership stakes tend to support continuity, which is crucial when a foreign entity cannot easily impose a new management culture immediately.
- **Reduced Owner Resistance**
 - Japanese SME owners often prefer internal continuity (employees) over external foreign buyers due to trust and legacy concerns. An employee ownership structure, even if enabled by foreign financing, may alleviate that resistance.
- **Leverage Existing Support Programs**
 - Employee succession could qualify for:
 - succession tax benefits if structured as an internal succession
 - M&A support programs (e.g., subsidies for advisory costs)
 - technical assistance via Succession & Transfer Support Centers nationwide.

As foreign SME succession and cross-border acquisitions gain relevance, access to clear, reliable, and well-structured information becomes essential. At Harrington Blue & Partners, we support individuals and organizations interested in these opportunities by acting as a practical entry point into complex and often opaque markets. We help reduce information gaps by providing cross-border market intelligence on regulatory environments and sector-specific opportunities. This allows prospective buyers, successors, and intermediaries to understand where opportunities exist and under what conditions they can realistically move forward.

Beyond information, Harrington Blue & Partners helps stakeholders navigate pathways to action, from explaining intermediary and succession vehicle options to connecting interested parties with relevant local experts, institutions, and networks. This guidance is particularly valuable for those at an early or exploratory stage who want to learn, compare markets, and assess feasibility before committing capital.

For more information about foreign SME succession, intermediary structures, or cross-border market dynamics, reach out to cecilia@harringtonblue.co.uk.

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