In the short term, the prospects for UK family businesses are good, but continued success in the medium to long term will depend on their ability to take some tough decisions, and address the all-important 'family factor'

The family factor: Professionalising the UK family firm

Family Business Survey 2014

UK

www.pwc.co.uk/familybusinesssurvey

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The survey results tell us that UK family firms remain a dynamic and resilient segment, and that they are emerging from the recession fit for the future and ready to make a decisive move forwards

Foreword

This is the fifth time PwC has surveyed UK family businesses, as part of a wider global survey which covered almost 2,400 companies this year. We spoke to 119 UK firms, from entrepreneurial start-ups to companies that have survived for five generations or more. The sectors were as diverse as construction, transport, and retail, and 40% of the respondents had a turnover of more than $100m. Two-thirds of respondents were owner-managers, and the rest CEOs or directors brought in from outside.

The survey results tell us that UK family firms remain a dynamic and resilient segment, and that they are emerging from the recession fit for the future and ready to make a decisive move forwards. This is the big picture, but when you look more closely at the detail it's clear that, in the UK as well as worldwide **there are significant shifts underway in the family business sector.** There are also new challenges to be addressed which all companies must confront, but which can raise particular issues for the family firm.

So what are these new challenges? Even if UK family firms have survived the downturn better than some other family business sectors across the world, the survey results prove that **competition is becoming more intense, price pressure is growing, and the speed of change continues to accelerate.** The family firm is often cited as an example of 'patient capital', and while this approach to business can raise some issues, it also offers important advantages, such as the ability to take a long view, and strong client relationships based on trust. But as this year's survey results show, family businesses across the world recognise that long-term survival and success will depend on their willingness to **adapt faster, innovate earlier, and become far more professional in the way they run their operations.** Depending on the market and the individual business, the professionalising agenda covers everything from IT systems and finance processes, to risk management and corporate governance. For the UK, in particular, the survey results raise some potentially worrying questions about family firms' willingness to change, and whether some of them may be underestimating the need for continual and relentless innovation.

Both in the UK and across the world, there has been a significant shift in priorities since the 2012 survey, with commercial issues now taking priority over softer concerns like the firm's contribution to the community. But in our view, there is an even more important finding in these results: **there is a powerful 'family factor' in play which many firms have still not addressed, and some are reluctant even to acknowledge.**

The most obvious place where this makes itself felt is in the question of succession. Only 13% of UK family firms have a succession plan that has been discussed and documented, and only one of the firms we spoke to where the CEO was over 65 had a formal succession plan in place (though this sample was very small). The 'passing of the baton' has always been a potentially perilous moment for the family firm, and **a number of factors are now coming together to make the succession process more hazardous than it has ever been before.** The gap between generations is lengthening, as people have children later in life, and as our Next Gen survey earlier this year showed, there are often dangerous communications gaps between those running family firms and the generation coming through, who may – or may not – be asked to take over. There are still too many examples of family firms, both in the UK and overseas, where there is no succession plan in place at all, or where this process is being approached as a personal issue between two individuals, when in fact there is no aspect of the family business where it is more important to apply rigour and objectivity. The risk, if this does not happen, is friction and contention, which will inevitably impair business performance and could be serious enough to threaten the long-term future of both family and firm. As one of our interviewees said, **"Family businesses generally fail for family reasons".**

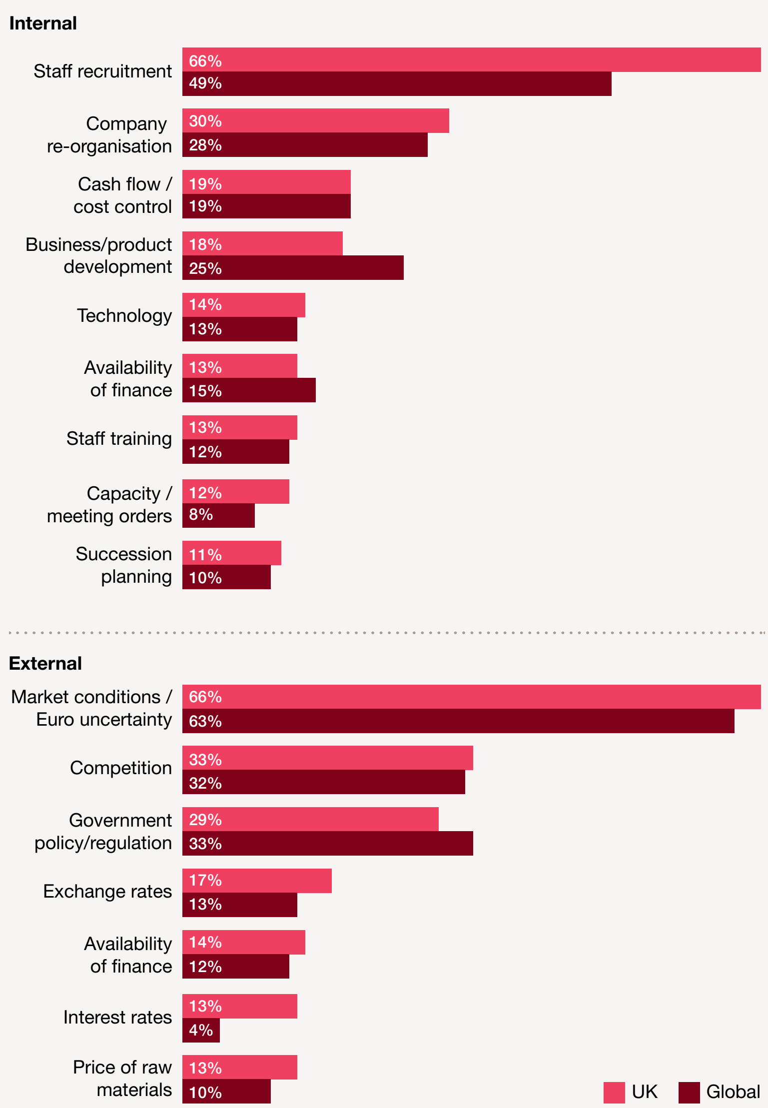
Succession has been a recurring theme of the Family Business Survey since it first began in 2002; the difference this year is the fact that succession is emerging as the most obvious manifestation of a much more fundamental issue: **family businesses need to professionalise the family, and not just the firm.** This is about family governance, as well as corporate governance: family firms need to address every aspect of the way the family interacts with the business and holds its managers to account. And the family members need to learn to be good owners as well as – or even instead of – good managers. In some cases this can even mean selling businesses the firm was founded on, if there are better prospects for growth and profitability elsewhere. Later in this report we look at one successful family firm which defines its role in these terms, and the lessons other family businesses might learn from this approach.

So the conclusions from this year's survey are both positive and thought-provoking. In the short term, the prospects for UK family businesses are good, but continued success in the medium to long term will depend on their ability to take some tough decisions, and address the all-important 'family factor', which can be the strength of this unique business model, but which can also bring it down.

Sian Steele
UK Family Business Leader

The new economy
More competitive, more volatile

Key issues in the next 12 months



In general, the family business sector across the world is in pretty good shape. 65% report growth in the last twelve months, which is exactly the same as the 2012 survey. In the UK, the position is even more positive, with 73% reporting growth in the last twelve months. This compares with 47% in the 2012 survey (though these figures may not be directly comparable, as the average size of businesses surveyed this year is larger). The growth plans of the UK family firm are also more ambitious this time, with 90% looking to expand in the next five years, compared with 81% in the 2012 survey. On a global basis 85% of respondents are aiming for growth over the same period, up from 81% two years ago.

However, closer analysis reveals a possibly worrying trend: UK firms – and those in other developed markets – are more likely to look for steady rather than rapid growth, compared with those in emerging economies. Only 8% of UK firms are aiming to expand aggressively over the next five years but the number is as high as 57% in China, 40% in the Middle East, and 40% in India. The comparable figure for the US is 16%, and for Germany 5%.

Firms in the UK are much more worried about their ability to recruit skilled staff in the next twelve months – 49% of global firms cite this as a concern, compared with 66% in the UK (where this figure has gone up from 47% in

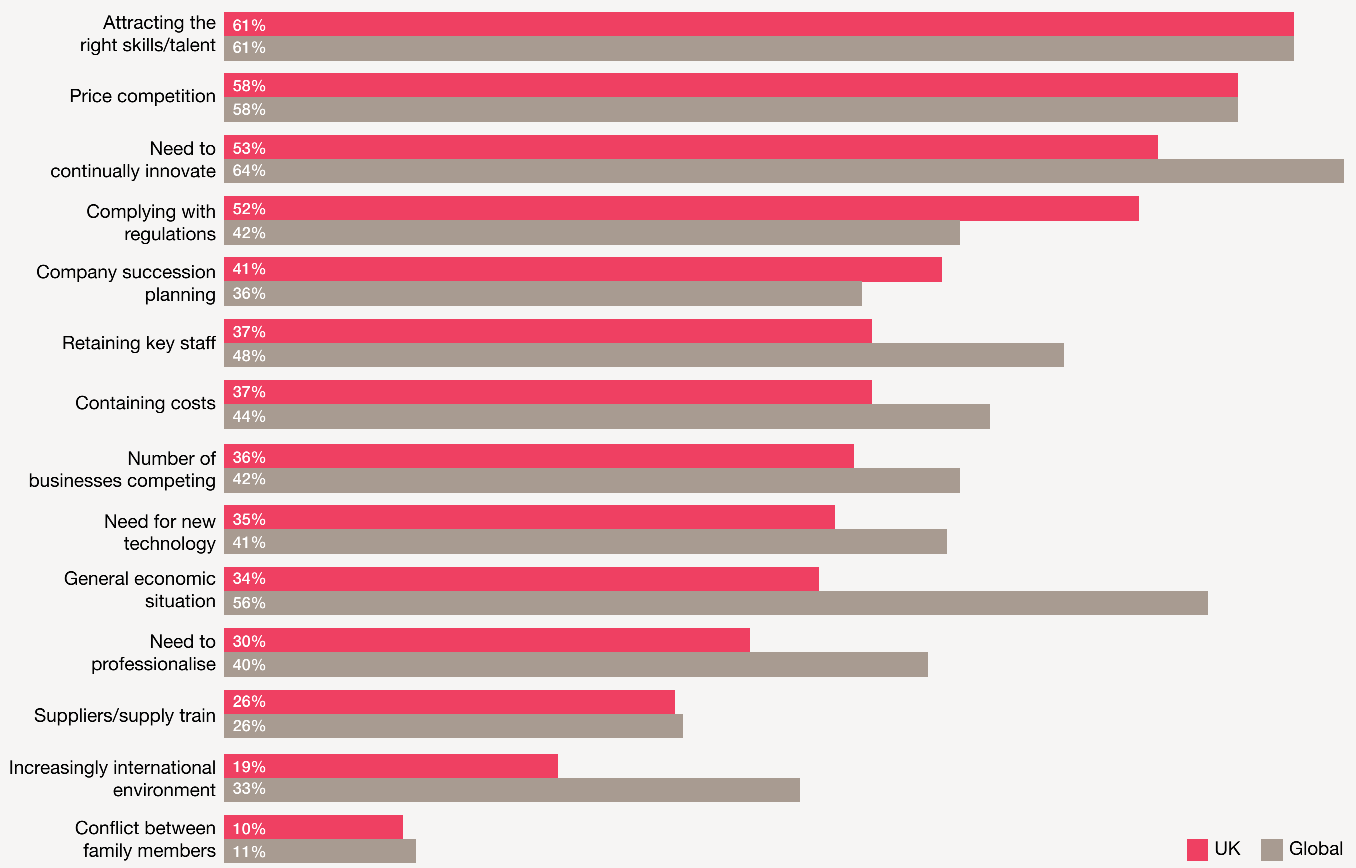
The picture is mixed: on the one hand UK family firms are confident and poised to move decisively into a post-recession world, but at the same time price pressures remain intense, customers are becoming more demanding, and margins are tight

2012). When you look outside the business at the market and other external factors, UK issues generally mirror global ones for the next twelve months – 66% say the general economic situation is their prime challenge for the next year (63% globally), and 33% are worried about increasing competition (32% globally). Over a five-year horizon price competition becomes a key external concern for both UK and global firms (58%), but UK firms are far less worried about the economy, or the challenge of globalisation.

So the picture is mixed: on the one hand UK family firms are confident and poised to move decisively into a post-recession world, but at the same time price pressures remain intense, customers are becoming more demanding, and margins are tight. Like family businesses all over the world, UK firms are facing a new economic reality, and the challenge of change. Global megatrends like demographic change, globalisation, urbanisation, and the digital revolution are transforming the business landscape, and the winners will be those companies with the agility and flexibility to adapt, and which are able to make the often significant investments required to keep pace with new technology. Companies, in fact, who are able to anticipate change and prepared to be disrupters, either in their approach to market, in their products and services, or in their willingness to change strategy and even sector, if that is where the opportunities lie.

In general, family firms intend to increase their international sales over the next five years, though this is another area where UK business are some way behind their peers: exports account for 16% of their turnover currently, compared with 25% globally, and the UK number is expected to rise to 22% over the next five years, whereas the global figure is predicted to increase to 32%. Most UK respondents are looking to Europe for these new markets (58%), but China (11%) and the US (15%) are also significant opportunities.

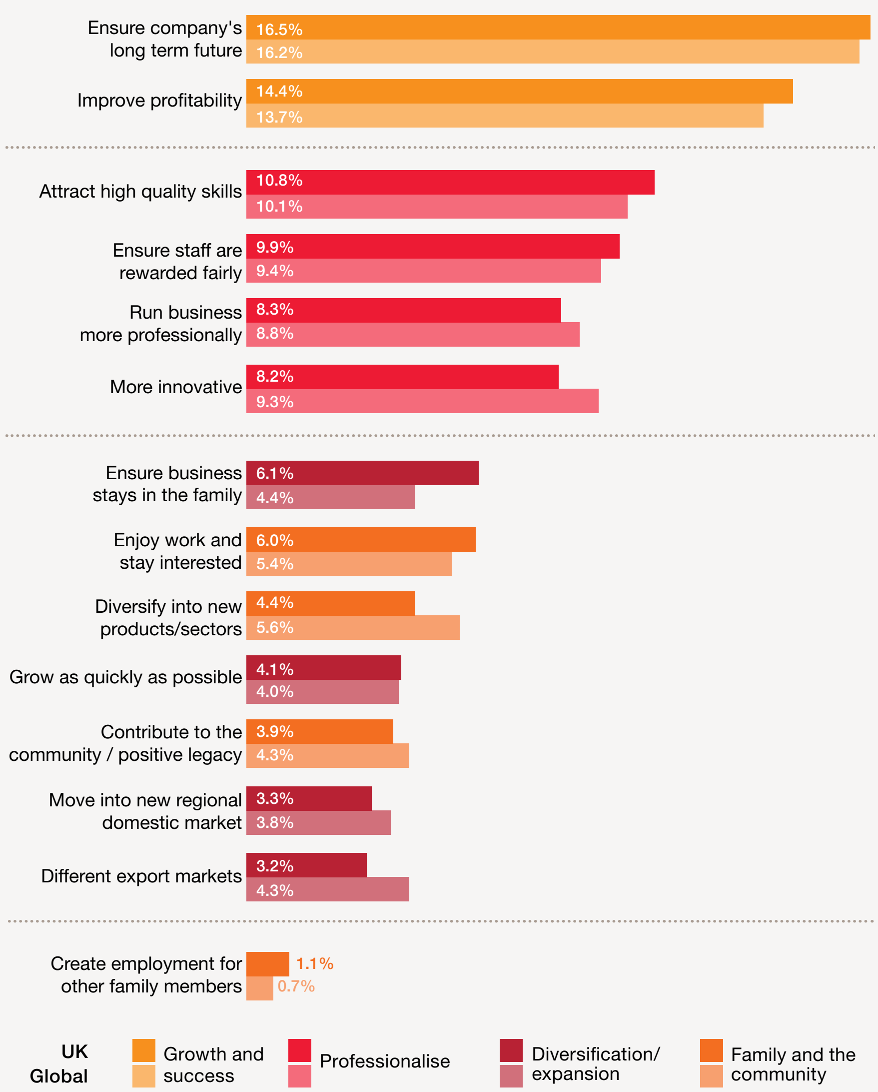
Key challenges in five years' time



Family businesses have become much more hard-headed since our last survey: the most important priorities are to remain in business and improve profitability

Surviving in the new economy
'Head' is winning over 'heart'

Relative importance of personal and business goals over the next five years (respondents assigned a % score for each, adding up to 100 in total)



This year's survey suggests that the new economic pressures are forcing many family businesses around the world to re-think their strategies and take some tough decisions. This is sharpening the tension already inherent in the family business model between family concerns on the one hand, and business objectives on the other: what you might call 'heart' and 'head'. As the chart (left) shows, UK firms are very similar to global ones in this respect.

Family businesses have become much more hard-headed since our last survey: the most important priorities are to remain in business and improve profitability. These are followed by the factors that will help make this happen, and the 'heart' issues of family and community come out very much lower. In 2012, 64% of UK firms questioned said they felt a strong sense of responsibility to support community initiatives, but that number is down to 45% this year. Likewise, in 2012, 89% of UK respondents said they did everything possible to retain staff in the downturn and 86% said they felt a responsibility to support jobs. Those numbers are down to 76% and 70% this year, which may indicate – as it does elsewhere in the world – that many family firms feel they have 'done their bit' to support jobs during the recession, and now need to turn their attention to improving profitability.

Keeping pace with change
No room for complacency

79%

of global family firms cited technological advances as one of the top three global trends most likely to transform their business over the next five years

53%

of UK firms cite innovation as a key challenge over the next five years, compared with 64% globally

22%

of UK firms believe that family businesses are more willing to take risks than other companies

In this year's 17th Annual PwC Global CEO survey, 81% of those questioned cited technological advances as one of the top three global trends most likely to transform their business over the next five years. Family businesses likewise recognise the growing impact of digital technologies, with 79% putting this in the top three. The UK figure is almost identical at 80%, but there are more significant differences in how UK firms are responding: 57% of global firms say they understand the business benefits of moving to digital, compared with only 46% in the UK, while 43% of global firms recognise that they will need to attract the right talent to help them do this, compared with 28% in the UK.

This may show that UK family businesses have their digital strategies well in hand, but if not, these figures are a wake-up call. This is particularly relevant when you look more closely at the global results: the countries registering the highest scores on understanding the commercial potential of digital were emerging markets like China (77%), India (69%), Kenya (69%), and Malaysia (69%), while the UK was one of the three lowest scores, along with Ireland (45%) and Canada (38%).

"It's tough knowing which is the right technology to be pulling out of and which is the right to be moving into"

5th generation

"The trouble with the Internet is that everybody knows the price of everything and the value of nothing"

3rd generation

Innovation in its widest sense remains a key concern for family firms in 2014, as it was in 2012, but it's potentially worrying that only 53% of UK firms cite innovation as a key challenge over the next five years, compared with 64% globally. This could indicate that UK firms are ahead of the game here, but it could just as easily suggest that many are in denial, either about their capabilities, or about how important this will be for long-term survival and success. It may also be significant that fewer UK firms believe that family businesses are more willing to take risks than other companies – only 20% compared with 38% globally. The UK figure is also down quite noticeably from 32% in 2012.

There is also evidence that both growth and innovation are a lower priority for businesses in their third or later generations, which place more emphasis on ensuring that the business remains in the family

The experience of our PwC teams around the world suggests that family firms in general are reluctant to change – even though family businesses continually claim that one of their strengths is their ability to reinvent themselves – 56% of global respondents said so this year, up from 47% in 2012 – there are not very many examples of firms that have actually done so. As one of our global interviewees said, "Family firms either don't want to reinvent themselves, or can't. In practice they find it hard to divest legacy businesses, and only expand or diversify within a narrow range."

"The shareholders are risk adverse, so it's difficult to expand"

2nd generation

"New product development is a challenge as we need to keep on innovating to keep ahead of the market"

4th generation

There is also evidence that both growth and innovation are a lower priority for businesses in their third or later generations, which place more emphasis on ensuring that the business remains in the family. In a mature market like the UK there will always be a higher proportion of such firms, in comparison with a country like Singapore, where many are still in their first or second generation. Though it's easy to see how the psychological factors that come into play as the business matures could make those running them more risk-averse and less entrepreneurial: later generations don't want to be the ones who 'lose the farm', and the number of family members dependent on dividends can be very large for a business that has been in existence for 50 or 60 years.

Professionalising the business
Moving to the next level

Professionalising is about giving structure and discipline to their vision and energy, so that family firms will be able to innovate better, diversify more effectively, export more, and grow faster

The need to professionalise the business is gaining ground as a key concern for family firms, with 40% of global respondents and 30% of UK firms citing this as a challenge over the next five years. The professionalising agenda is being driven by an almost perfect storm of competitive pressure, rising costs, and global megatrends. As a theme, it scarcely registered in 2012, but emerged very strongly in our PwC Next Gen survey[1] earlier this year, when a number of the upcoming generation told us they want to formalise and modernise the business when they take over.

Taking a global perspective, it's the younger and more ambitious businesses who are more likely to put a high priority on professionalising the firm. They are more aware of the risks and opportunities of the move to digital technology, and more likely to think of the family business model as slow to accept new ideas. They're more likely to be looking at a possible Private Equity exit strategy, and will know that these investors will look for a well-managed and disciplined operation. This applies equally to those looking to undertake an IPO.

So what does 'professionalising the business' mean for the UK family firm? What areas does it cover, and what are family businesses doing to address it? The first thing to say is that it's not about process for its own sake, or about weighing down the entrepreneurial flair that launched the family firm in the first place. It's about giving structure and discipline to that vision and energy, so that family firms will be able to innovate better, diversify more effectively, export more, and grow faster.

1 *Bridging the Gap: Handing over the Family Business to the Next Generation, PwC, April 2014*

A key theme has emerged in different ways throughout this year's survey: how does a family firm keep the entrepreneurial energy and flair of its early years with each succeeding generation?

Professionalism in practice
Processes, governance, skills

There are three distinct areas where UK family firms are feeling the need to professionalise their operations. Some of this is fairly basic work around systems and processes, but progress is also being made on corporate governance, and on people management.

Processes

Though there are some family firms that manage without formal business processes – especially first-generation entrepreneurial start-ups – most larger UK firms now have documented procedures and policies, if only to achieve compliance in areas like Health & Safety and employment law, where the regulatory framework is more complex and sophisticated that it tends to be in emerging markets. Indeed UK firms are notably more concerned about regulation than the global average, with 52% citing this as a concern over the next five years, compared with 42% globally.

"We need the resources to deal with an ever-increasing level of bureaucracy and legislation"

3rd generation

Many UK firms are automating their operations and increasing their use of IT as a way to improve productivity and efficiency, and to counter the cost pressures we have already discussed. They are also being more systematic and structured in their approach to sourcing, again as a result of rising costs.

"Changing a lot of our internal processes is going to be a challenge, for example our HR and payroll process"

2nd generation

"There is too much duplication and paperwork - we need to professionalise the business in that way, we need a big IT commitment"

2nd generation

"The business was founded by my father and it was set up by just one man. He is now retiring and there is a whole level of bureaucracy and formalisation of processes that we have to put in place to formalise what he has done with the business"

2nd generation

"If we professionalise the business in terms of financial performance the rest will follow"

1st generation

Governance

The corporate governance of the family firm has improved since 2012, and our own experience of working with family businesses also suggests that this is the case. More UK family businesses are seeing the value of appointing experienced non-executive directors, though it can be hard to find and recruit people with the right expertise, as family boards are often perceived to be more problematic than those of conventional companies.

"I think we need to 'depersonalise' the business so that it is less about one person going forward. This is something in the agenda for the future, however, no particular steps have been taken in this direction so far"

2nd generation

"When I was younger the family was the company's strength; when the second and third generations come in they are being fed with a silver spoon"

3rd generation

These quotes capture a key theme that emerges in different ways throughout this year's survey: how does a family firm keep the entrepreneurial energy and flair of its early years with each succeeding generation?

Skills

Attracting and retaining skills and talent continues to be both a concern and a challenge, as family firms can struggle to compete with the share options and structured career paths offered by major multinationals. As one interviewee put it, "recruiting senior staff is difficult because they don't see a career with a family business." As we saw in the earlier chart, skills rank very high in UK family firms' list of priorities, and 61% list this as a key issue over the next five years.

The issue of skills is also fundamental to other key areas of concern: if family firms are to expand internationally, diversify into new markets, manage risk better, or innovate more effectively, many of them will need to buy in the people to do it. And there's no point in hiring those people unless you have professionalised the systems and processes that will make it possible for them to do their job.

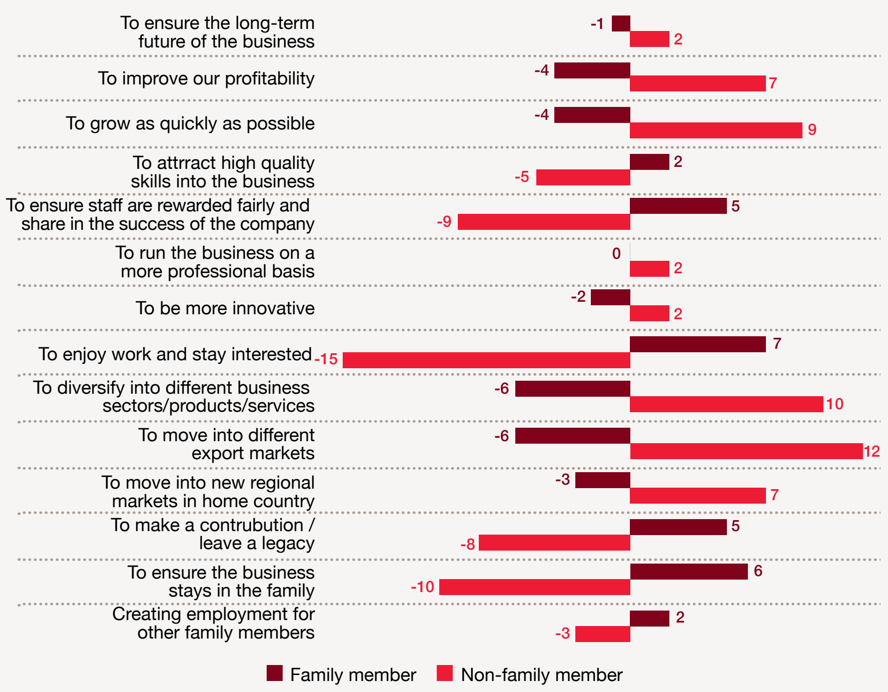
When it comes to skills, 'professionalising the business' frequently translates to 'bringing in professionals to run it'. This is often the right decision, especially when the business reaches a certain critical scale, but it can still be a challenging moment for the family firm. When you bring in outside managers – especially at executive level – the dynamics of the family firm inevitably change.

The family factor: Leaving a legacy

The importance of the personal legacy is one of the key differentiating features of family businesses. Again and again, our respondents talked about wanting to leave something worthwhile behind, or as several interviewees put it, "to be remembered."

So even if family firms are putting business issues first this year, the pull of the personal legacy remains very strong. Many UK respondents want to 'make a difference', and say they want to pass on a business that is healthy, sustainable, and profitable. They also talk about creating employment, ensuring security for their family, and supporting the community – all issues that have slipped down their overall list of priorities but come sharply into focus when the emphasis shifts from the professional to the personal. This is clearly a highly emotive issue and is no doubt related to the fact that most family businesses bear the family name.

Key differences between family and non-family on a global basis leaders; indexed to the overall average



A different set of stakeholder interests comes into play and the business becomes less like a private entrepreneurial venture, and more like a public company. The challenge for the family is managing that transition, and recognising that they themselves have to change if it is to be a success. They have to accept a loss of control and an increase of discipline, both of which can be difficult, especially when there are strong personalities involved, as is so often the case.

"A key challenge is transitioning from being a business with lots of family input to one appointing outside management in key positions and functions"

2nd generation

"There was a reduction in our skills base during the recession and we are now in a war for talent against our competitors"

4th generation

"It's a challenge to recruit suitably qualified engineers to help with new product development"

3rd generation

The global survey results show that non-family members are much more likely to be pushing for aggressive growth. Innovation, international expansion, diversification, and professionalising the business are likewise higher priorities for them than for those who are family members, who tend to be more focused on family and community, and more concerned about a personal legacy (see the box-out on the previous page). There are important questions here for family firms, because one interpretation of these figures is that family businesses can either under-perform or lack ambition if they are run by family members, and that this wouldn't be the case with an outsider in charge. A recent PwC study on family businesses in Germany[1] found that more of them are now hiring outsiders at a senior level, and – crucially – those who have done so are growing faster than those who have not.

1 *Growth patterns and internationalisation of German family-owned businesses and family business owners. PwC Deutschland, February 2014*

But recruiting a top-quality CEO is no easy task; as one of our interviewees put it: "if you bring in senior talent you have to be able to keep it."

"There needs to be some management changes so that the outsiders (non family members) also get some autonomy, recognition and ownership"

3rd generation

On the one hand, the long-term perspective of the family firm should be attractive to talented candidates, giving them scope and time to prove themselves, especially given that the average tenure of a CEO in a Fortune 500 company is now down to as little as five years. But on the other hand, a study in the *Harvard Business Review* in 2013 found that the optimum tenure for a CEO is not much different from this, at 4.8 years, and after that performance begins to tail off – something family firms might want to bear in mind[2]. In any case, many potential applicants will be wary of taking a senior role in a family business, given the difficult and sensitive issues involved, and the potential for in-fighting among family members, both on the board and off it.

Deterring the best talent is only one example – albeit an obvious and critical one – of how family issues can hinder business success. As this year's results make clear, professionalising the business is necessary, but not sufficient alone, to long-term survival. The most pressing priority is the need to professionalise not just the firm, but the family.

2 *Long CEO Tenure Can Hurt Performance, by Xueming Luo, Vamsi K. Kanuri, and Michelle Andrews, Harvard Business Review, March 2013*

The heart of the matter
Professionalising the family

The strength and weakness of the family business model is right there in the name: the family. Working with your relations can generate much higher levels of trust and commitment, but it can also lead to tensions, festering resentments, and open conflict, as the individuals concerned struggle to keep 'head' and 'heart' separate, and make a success of both their work and family lives.

Because it involves heart as well as head, professionalising the family is much harder than professionalising the business, and often gets postponed simply because it raises too many intractable issues. But it cannot be put off forever, and the risks of not facing up to this challenge will increase with time. As one Middle Eastern respondent put it, "It's only a matter of time – it may not happen in the second generation, or the third generation, but conflict will eventually arise at some point." This potential for conflict is one of the main reasons why so few family firms survive beyond two or three generations: as Dr Eric Clinton of Dublin City University says, "in a family business the hard issues are the soft issues."

In PwC's recent Next Gen survey we identified three 'gaps' which can undermine a successful transition between generations: the generation gap, the credibility gap, and the communications gap. The communications gap is particularly relevant here, as the Smorgon Consolidated Industries side panel proves. That story also shows that even in a large and successful business, there is a very real risk that family issues will eventually precipitate a crisis for the firm as well as the family, and both may fail as a result. As with so much else, these issues need to be addressed in the good times, because kneejerk decisions made during a crisis rarely result in the ideal outcome.

Family values: The Entertainer

The Entertainer was founded in 1981 by husband and wife team Gary and Catherine Grant, and it's now the biggest independent toy retailer in the UK, with over 1,000 employees and 90 stores across the country. Two of the Grants' children have now joined them on the Board, which also has two non-family members. The business has a string of awards to its name, including, most recently, Family Business of the Year 2014 at the PwC Private Business Awards.

So to what do they attribute their success? A lot of it comes down to the strength of the family's values, which were implicit in the business from the start, and have recently been formally launched across the firm. Values can be especially powerful in a family firm, and as the business evolves and passes down the generations, it's important that the family is clear about what its values are and how they are expressed, both in the way the business operates, and in the family's own affairs. The Entertainer's values are caring, ambitious, demanding and 'the playground'. As Gary Grant says, "That last one is where it all comes together – what makes it all work. We believe the family makes a positive difference by our enthusiasm, our work ethic, the excitement that we demonstrate, and possibly most importantly, by the fact that we really do care, not just for the children who buy our toys, but the whole community, and especially our own employees."

One example of that care for its own staff is the fact that, despite increasing pressure for stores to open seven days a week, The Entertainer does not open on Sundays, to create space for family life. Likewise while Gary and Catherine still own the majority of the shares, everyone has the opportunity to earn bonuses, and there is a strong commitment to open communications and personal development – there are training days throughout the year and employees earn more if they complete specific modules. There's also a ten-year club celebrating the contribution of staff who have been with the firm for more than a decade - the fact that it has over [ ] members is a tribute to the fact that working in 'the playground' is as much about fun as it is about fulfilment.

"Family businesses generally fail for family reasons": Smorgon Consolidated Industries

David Smorgon is a former director and Senior Executive of one of Australia's largest family businesses, Smorgon Consolidated Industries. The family business survived for 65 years and was into the fourth generation when it surprised the market in 1995 by announcing a staged divestment and sold off every single asset over the next couple of years.

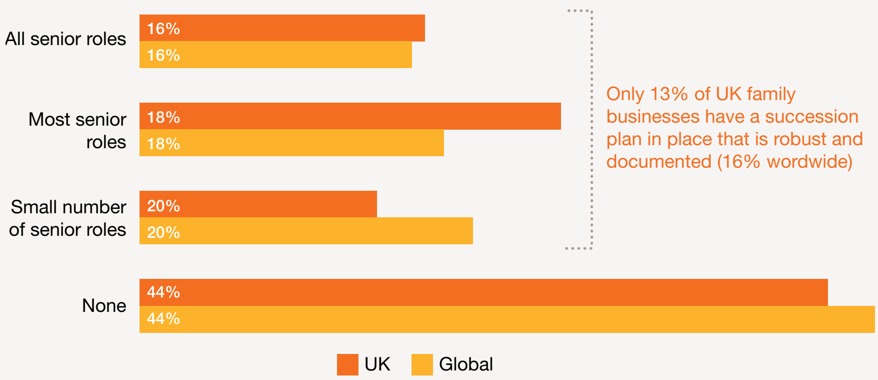
David became the inaugural Chairman of Family Business Australia and is now Senior Advisor - Family, Business and Wealth as part of PwC's Private Clients team in Australia. We asked him what others can learn from his experience.

"We were a complex family with seven different shareholder groups and we had three generations working in the business at the same time, numbering around 20 people aged from 20 to 80 years old.

We were excellent communicators on business issues. However, we did not spend enough time discussing family issues. We should have allowed time for family to air their grievances through regular family meetings, which were specifically focused on family, not business issues. Similarly, we continued to defer discussions on succession because it's such a secretive, difficult and confronting issue. We didn't understand that succession is a process not just an event."

So what advice would he give other family firms? "You need to assess the health of the family with same depth and rigour as you assess the health of the business – look at what's working and what isn't. Some of it is about family governance, but it's also about softer issues like the way people behave with each other, and the respect – or lack of it – between family members. You do also need the processes in place to head problems off before they get engrained. But if you can fix the family issues the business issues are much easier to solve. That's the good news."

Succession planning in the UK family firm



Professionalising the family means putting processes in place to govern how the family interacts with the business, which includes establishing an infrastructure for decision-making, and formal channels for communications that can supplement the informal ones, and will come into their own during times of tension or difficulty. It's about protecting the family's interests, and safeguarding the firm's survival. In other words, it's the vital family governance piece which must sit alongside the equally important corporate governance structure.

This year's survey shows that an increasing number of UK family businesses have mechanisms in place to deal with potential conflict, and that there has been further progress in this area since 2012. 82% have at least one procedure in place, including provision for third-party mediation (22%), and family constitutions (17%). UK firms are more likely to have incapacity and death provisions than the global average (54% compared with 43%), and less likely to have shareholder agreements (46% against 54%), or family councils (18% against 32%). Only 18% have nothing at all.

More family business are setting up family offices as well, either dedicated or shared. These offices, in their turn, are also becoming more professional, moving beyond 'concierge' services to relationship advice, family counselling and, where necessary, mediation. (See the box-out later in this report).

But – and it's a big *but* – the all-important issue of succession has still not been fully grasped or effectively addressed by far too many UK family firms. 56% say they have a succession plan in place for some if not all senior roles, but when questioned further, only 13% have a robust and documented succession process (this is even lower than the global average of 16%). A plan that is not written down is not a plan, it's just an idea, and this is an issue family firms must address with the same commitment and energy as they are devoting to professionalising other aspects of the business. Because without it, the entire enterprise is at stake.

Bridging the gap
Making a success of succession

The passing of the baton has always been a hazardous moment for the family firm, and never more so than now. The world has changed out of all recognition since the current generation first went into business 30 or 40 years ago. Thanks to the post-war baby boom there are a lot of UK businesses which were set up in the second half of the last century which are now facing their first significant transition. The 'generation gap' is widening literally as well, as people have children later. This means that the periods between each transition are lengthening, which puts even more strain on a rite of passage which is already fraught with potential problems.

As the business gets older, more potential successors come into play, the numbers in the wider family grow, and the potential for conflict rises. As one of our interviewees pointed out, "The transition from the first to the second generation is the easiest. After that it gets progressively harder. The bigger the family gets, the more likely it is that there will be people who have never worked in the business and don't understand either it or its issues, but are still expecting to receive their dividends. That's bound to cause tension, especially when people react emotionally rather than rationally."

In many cases the word 'succession' itself can provoke an extreme emotional reaction, especially in the founder or current CEO. It's an unwelcome reminder of age and mortality, and threatens loss of influence and redundancy, in the widest sense of the word.

No surprise, then, that so many family firms exhibit 'sticky baton' syndrome, where the older generation hands over management of the firm in theory, but in practice retains complete control over everything that really matters. No surprise, either, that so many incumbent CEOs either evade or block any discussion about succession with those who expect to take over. This creates uncertainty, which is unhelpful both for the individuals and the firm, and in extreme cases can lead to a complete disconnect between what the incumbent is privately planning, and what the next generation is expecting.

"There has been no discussion of succession, it's not something that gets talked about with my father"

Next Gen survey interviewee

"I wasn't sure how the whole succession thing would work out, because at that stage my uncle and my father owned the business and there was no agreement tabled or even discussed in the early years"

Next Gen survey interviewee

"It's still my father's business and everything is absolutely his decision. He will judge when the time [for succession] is right and no one else will say when that will be. It is not up for discussion so that will be a challenge"

Next Gen survey interviewee

In our Next Gen global survey, 73% said they were looking forward to running the business one day, but only 35% thought that was definite, and as many as 29% thought it, at best, only fairly likely. And in the main 2014 survey, 41% of those currently in charge agreed that it will be difficult to let go, but that number rose sharply to 64% when we questioned those who will be succeeding them. This is another example of the communications gap that can bedevil the family firm – as Roy Williams and Vic Preisser say in their 2010 book, *Preparing Heirs*, 70% of intergenerational wealth transitions fail, and many of those failures are due to a lack of openness and transparency.

Succession will always be an emotive issue, which is all the more reason why it needs to be managed on a professional rather than a personal basis. Too many family firms are still approaching it as a one-off event rather than a long-term process. In our experience, a well-managed succession process can, and should, take several years.

We are also seeing an increasing number of family firms requiring younger family members to go through a proper development programme before entering the firm, and in many cases this includes a spell working outside the business.

"This generation came into the company from the start and worked up, but the next will have to be different"

2nd generation

This 'professionalising' of the next generation is helping to close the third of the three gaps – the credibility gap. 59% of participants in the Next Gen survey said that winning the respect of their co-workers was one of their biggest challenges, and many of the other issues they cited are closely related to this, including understanding the complexity of the business (44%), being asked to take on a job they feel unable to do (18%), or taking on responsibility too early (9%). In the same survey, 88% of the next generation across the world said they have to work even harder than others in the firm to 'prove themselves', not only with their colleagues and employees, but also with customers.

Of our Next Gen interviewees, only 7% had gone into the family business straight from school, as their parents and grandparents typically did. 55% had gone through a professional development programme, 14% had taken business degrees, 34% had been on management and training courses, and 46% had worked for another company before joining the family business. The latter, in particular, can provide an invaluable insight into the crucial difference between owning and managing a business.

The family factor: Balancing influence and controly

Our experience suggests that one critical factor in a successful succession is whether the firm can find a way for the older generation to retain a positive influence, even after they have ceded control. As one of our Next Gen interviewees put it, "What we want is the right balance between influence and control, so that my parents still have a say about what type of company we are, without getting into the day-to-day detail on every issue, especially as they get older and aren't so close to what's happening on the ground. It's a hard mix, in a family business, but it's worth working at it to get that balance right."

This is a good example of the last of the 'four Ls' identified by Mary Barrett and Ken Moores, who was founding director of the Australian Centre for Family Business. They believe you need to learn four key skills to run a family firm: learn business, learn your own business, learn to lead, and learn to let go[1]. The last of these is definitely not the least, and can often be the hardest of all.

1 *Learning Family Business: Paradoxes and Pathways, Ken Moores and Mary Barrett (2002)*

'Family education' and professionalisation: Insights from an expert

Peter May is a specialist in family businesses, and the founder of INTES, the first training and consultancy company in Germany focused on family firms, and he also collaborates regularly with PwC. He's written many books and articles on the issues these firms face, and has been instrumental in creating the German Family Entrepreneur of the Year Award.

We talked to him about the results of this year's global survey, and what insights he can share on the challenge of professionalising the firm, and the family.

What do you believe professionalisation means for the family business, and what are the risks and opportunities for families?
What distinguishes family businesses is their ownership structure, and a corporate culture which crosses generations. They require different strategies, different financing concepts, and different governance regulations from other types of companies. These special qualities give rise not only to certain benefits but also to disadvantages and challenges. When the family can exploit the advantages and meet the challenges, the family business can look forward to long-term success – economically successful, socially responsible and locally anchored.

But those who can't meet the challenges which running a family business entail are destined to fail, I cannot put it more plainly than that.

In your experience, how are family firms rising to the challenge of professionalising their operations?
There's been a huge increase in the professionalisation of family businesses in the last 20 years. Those who have done this successfully have understood that managing a family business well requires not just one but two different governance systems. It isn't enough to solely concentrate on the business – the family needs managing as well. In the last few years we've come to appreciate the hugely important role which ownership plays in a family business, and that a family doesn't necessarily have to run its business itself; its principal duty is to ensure professional leadership for the business.

As more families look to pass on ownership but not management of the family business to the next generation, how do they best equip themselves to be responsible and effective owners?
The more we understand about the important role played by the owners in their family businesses, the more we also understand how important it is to prepare and train the family for this task: an informed shareholder is an effective shareholder.

Well-managed family businesses offer their shareholders special training programmes which enhance their ownership capabilities, and provide insights into the issues relating to company management as well as an understanding of family dynamics. They explore the theory and the practice, not just in general terms but also with a specific focus on the family business itself. Hands-on work experience is a fantastic way of getting to know your own company and for developing pride in it. And the opportunity to network with the members of other owner families and exchange experiences with them provides benefits which can be incorporated into the 'family education' programme.

The first place to look for the best people for the job is within the family, so it really does pay to invest in the future of your owners

How can families keep the spirit of entrepreneurship alive as the business passes from one generation to the next?
Possibly the greatest challenge facing family companies and their owners is keeping the entrepreneurial spirit alive. This applies today more than ever. Globalisation has greatly accelerated the rate at which things change and life cycles are getting shorter. The old saying, 'It takes

three generations to build a business' might soon be outdated, replaced by 'One generation can build three businesses'.

In this digital age it's less important to hand on trademarks and machines than entrepreneurial spirit. That's not as easy as it sounds, since a family's increasing prosperity leads inevitably to a degree of complacency and inertia among its members. They prefer to enjoy the wealth they have rather than strive for more. That's why it's so important that we drill into our children to 'stay hungry'! There is another old saying that 'the first generation builds the business, the second makes it a success and the third wrecks it'. Now more than ever, we have to remember the truth of that.

Family businesses tell us that two of their biggest challenges are innovation and skills - how do you see family businesses 'staying ahead of the curve' and what issues does this raise?
Innovation, diversification, entrepreneurial spirit and the skills connected with them are becoming increasingly important in the new and dynamic business environment. They have to be instilled in the family, and anchored in the corporate culture of the business.

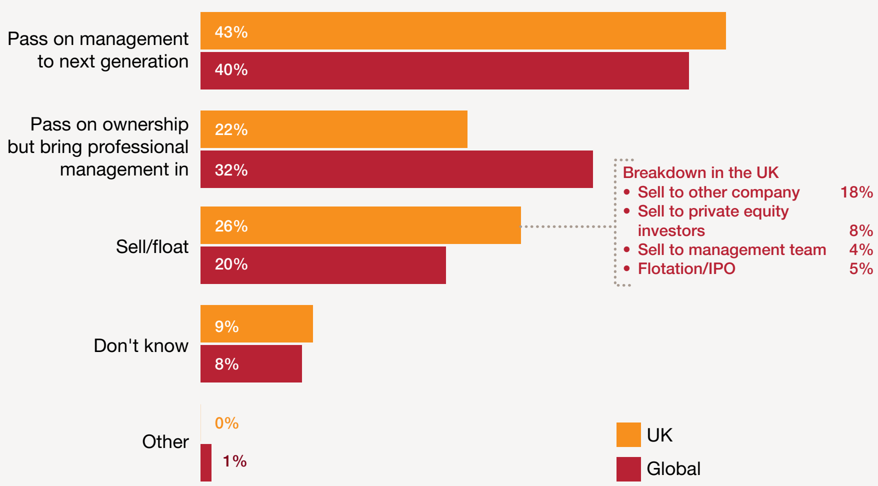
No family can perform every role within the family business, so in order to attract the best people, family businesses have to work harder than ever before to make themselves attractive places to work. In particular, they have to create space for innovators, both from within and outside the family. This means they have to make changes, becoming more open and inclusive, rather than exclusive and inwardly-focused. They need to offer exciting compensation and participation models, and play to their greatest strengths: owner families can provide a human touch and a sense of belonging – an invaluable advantage in a world where it's getting harder and harder to make a personal connection.

Six ways to address the 'family factor'
So to sum up, here is Peter's advice to family firms:

1. It's not enough to manage the business – you need to manage the family too.
2. As a family, your role is to ensure the best professional leadership of the firm, and a family CEO might not always be the right choice.
3. Prepare and train the family for the task of ownership – in other words, invest in your future shareholders.
4. Network with other family businesses and share your learning and experience with them.
5. Keep the entrepreneurial spirit alive. One way to do this is by creating space for innovators, both inside and outside the family.
6. Play to your strengths in attracting talent: a family business can be a special place to work, offering a human touch and a sense of belonging which is becoming increasingly rare in other types of company

From managers to owners
The new model for the family firm?

What UK firms are planning at the next transition



Understanding the difference between ownership and management is becoming more important, because owning-only is a trend that appears to be gaining momentum: 22% of UK family firms are looking to pass on ownership, but not management, to the next generation according to this year's survey. And as the moment of succession approaches, more companies are actively looking at this as an option.

> *"I would like my lasting legacy to be that each of our businesses are in a good place and in a good strong position to be sold or bought out. I don't see it continuing within the family"*
>
> 3rd generation

There are also some forward-thinking family firm CEOs who are open-minded about the next generation's involvement, because they see the family business as meritocratic, not dynastic. They would be happy to see the next generation take over, but they accept that management may skip one or even two generations, and that the firm may not revert to family management at all. However, there are others working in family firms who

There are some forward-thinking family firm CEOs who are open-minded about the next generation's involvement, because they see the family business as meritocratic, not dynastic.

clearly believe they are entitled to manage the firm if they choose to do so. But if there is a birth-right in the family business, it's the right to ownership alone; some firms might benefit from a culture change that would endow the role of owner with the same status and value as that of CEO.

Ownership is not an easy option, however: it has to be undertaken as an active choice, in the knowledge that it will require new skills and may even entail specific training.

When family members are owners not managers it's even more vital to formalise and professionalise the relationship between the family and the firm. This is about accountabilities and responsibilities, but families must understand that these work both ways. On the one hand the family must hold management to account for the performance of the business; but they must also be accountable and responsible as shareholders, and clear about their expectations. Holding management properly to account requires robust and objective assessment criteria such as KPIs; being a good shareholder demands a full understanding of the firm's strategy, operations, and objectives, and – crucially – an appreciation of the difference between involvement, which is helpful, and interference, which isn't.

Being an effective owner also means being an effective custodian of the family's values – the principles and priorities that give the firm its character and its continuity. The family office can often play a useful role here (see side bar).

But in some family firms continuity derives not just from consistent values but a consistent approach to business, regardless of the specific nature of that business. These firms do not care where they operate or what they sell, as long as they are profitable. They have freed themselves from the emotional ties that can leave family firms shackled to outdated ways of working or under-performing divisions which were either set up by previous generations, or are run by a family member and therefore 'unsellable'.

Head and heart: The changing role of the family office

Family offices come in many different shapes and sizes: anything from a finance director or legal counsel who spends some of their time dealing with the family's personal affairs, right through to teams of advisors managing all the family's investment and personal affairs, as well as concierge services For many families, the use of an office will be driven by a lack of time, for others it will be about actively managing their affairs, and dealing with investments in new ventures outside their core business.

In recent years there has been a lot more awareness of the value of family offices and as family businesses have become more complex, the traditional family office is evolving to meet their needs. In many cases this means operating not just in traditional 'head' areas like tax planning and asset protection, but in softer 'heart' areas too, including advising parents and children on the psychological aspects of bequeathing and receiving wealth, and supporting younger members of the family to gain the professional and personal development they will need to be effective owners or managers. And many family offices are also now taking an active role in helping the family to define and codify its values and ethos, to ensure these principles continue to inform the way the business operates, whether or not a family member is CEO.

The changing role of the family office reflects the increasingly global footprint of many families and also the drive for greater professionalisation. For large multi-generational families transparency and communication are key, and family offices continue to look for effective and safe ways to communicate with multiple stakeholders. We see digital technology and social media becoming a key part of these programmes.

‘Our business is to stay in business’ *The International Group*

Name	Hertford King, CEO
Sector	Conglomerate
Market	UK
Founded	1964

Hertford King is CEO of the International Group, a highly successful family business first set up by his father in 1964. Today, the company brings together businesses as diverse as hotels, healthcare, property and packaging, and reflects the equally diverse business career of Hertford’s father Roger, who founded the business. Roger King started out as a jeweller, then expanded over the years into property development, advertising, and packaging, among others.

Many of his investments were the result of astute deal-making, and in some cases a smart acquisition opened up a completely new area of opportunity, which his sons have been able to exploit. The most obvious example is Stoke Park, which Roger bought as an office investment, but which his sons thought would have more potential if redeveloped into the country club it had been once before. And how right they were: Stoke Park is now a world-famous luxury venue and the flagship of IG’s hotel and club division. Better still, the expertise gained through running and re-launching Stoke Park is now marketed as a service for other companies looking to invest in high-end sports venues or clubs.

Turning deals into businesses

It’s a perfect example of how the company works: as Hertford says, “My dad is a creative person and he likes doing deals, but he's not someone who will sit down for hours talking about management process or systems. But that’s what my brothers and I do – we are managers rather than deal-makers, and our skill is turning deals into businesses. And that works very well.” And it’s still working well, as shown in IG’s successful launch in China, which is the latest addition to an international operation that now covers over 50 countries.

China is a huge growth opportunity for both the healthcare and leisure businesses; as Hertford says, “There are two industries which are seeing massive growth right now and they are leisure and healthcare. The latter’s being driven by ageing populations, as well as by rising incomes, which is seeing people and governments across Asia willing to pay more for healthcare. The same affluence is opening up huge opportunities in leisure too. In China we’re positioning ourselves as a company that can connect health, wellness and leisure together for whole communities. That’s very exciting.”

Hertford is the eldest of Roger’s three sons, and worked first for a major firm of accountants before going into the family firm, where he was later followed by his two brothers. Their roles have evolved over time, but each contributes a particular skill set, as well as running part of the group. Hertford’s youngest brother Chester studied marketing, and runs the leisure business, Witney King focuses on risk management and procurement, and runs the healthcare division, and Hertford oversees core functions like IT, finance, and legal, which span the whole portfolio.

This level of responsibility came early. Even when the brothers were comparatively young, their father wanted then to have a stake in the firm’s success, so he made them directors and gave them 10% of the company each, retaining 70% himself. The company has no outside shareholders, and takes a flexible approach to management and governance in which the family is supported by an informal group of business advisers with expertise in specific sectors. It also has an active Corporate Responsibility programme, with projects that include working with Moorfields Eye Hospital in Ghana.

In the last twelve months there has been one significant change at IG – perhaps the biggest since the company was founded. Though still very active in the day-to-day running of the group, Roger has taken his stake down to 25%, with each of the sons now owning 25%. But he retains a casting vote at Board meetings, in the event of a three-way split. The change in shareholdings is part of a long-term plan to ensure a smooth succession, which will also include a formal shareholders’ agreement.

The International Group is a good example of a successful family firm that defines itself in terms of its expertise, rather than the specific portfolio of businesses it happens to own at any one time.

The family is very mindful that its own success is not necessarily typical of other similar firms, and family unity has to be worked at: “Most family businesses don't last very long unless you're very fortunate, or smart, or both. The problem is that the family starts by creating a business and then ends up being controlled by the business and not the other way around. Everything in a family firm is a double-edged sword – you have more flexibility which is good, but less discipline which might not be. And I think it’s harder for people in the third, fourth or fifth generation, as all you can do is lose something other people have built. The other thing is I think our concept, which is different to a lot of founders, is that they only have one business and they’re committed to that because they've been in it for many generations, whereas our business is to stay in business and we don't necessarily care what the business is.”

By professionalising the family, the sector as a whole could reinvent itself, and evolve from a model based on a 'family business' to one driven by a new vision of the 'business family'.

Conclusion

Professionalising the business will allow UK family firms to innovate better, diversify more effectively, export more, grow faster, and be more profitable. It will open up new commercial opportunities, and new options for a possible sale in the long term, by making them more attractive prospects for both PE buyers and multinational buyers.

But these benefits will only be realised if family businesses have the courage to professionalise the family, as well as the firm. Doing one and not the other will only create tension and possible conflict, especially if outside managers are brought in at executive level. Professionalising the family is much harder, and will take longer, and it's understandable that many family firms are shying away from tackling an issue so fraught with potential conflict. But it cannot be postponed indefinitely. The choice is to do it slowly and painfully, or quickly and painfully. But the rewards will be significant for those who do seize this challenge, while the risks of not doing so will increase with time, especially as it's likely that the failure rate of the family business sector will rise as the pace of change in the wider economy accelerates.

Professionalising the family will ensure that family members become effective owners, whether or not they are actively involved in managing the firm. It will make it possible to reinvent the business, by taking the objective perspective of the informed investor, rather than falling prey to decisions dictated by emotion or history. We have already seen, in the International Group case study, how liberating this approach can be. By professionalising the family, the sector as a whole could reinvent itself, and evolve from a model based on a 'family business' to one driven by a new vision of the 'business family'.

Definitions

For the purposes of this survey, a 'family business' is defined as a business where

1. The majority of votes are held by the person who established or acquired the firm (or their spouses, parents, child, or child's direct heirs);
2. At least one representative of the family is involved in the management or administration of the firm;
3. In the case of a listed company, the person who established or acquired the firm (or their families) possess 25% of the right to vote through their share capital and there is at least one family member on the board of the company.

Survey methodology

For the global report, 2,484 semi-structured telephone and online interviews were conducted via Kudos Research in London with key decision makers in family businesses in over 40 countries worldwide between 29th April 2014 and 29th August 2014. The global figures in this report take into account the responses of 2,378 respondents. The turnover of participating companies was from \$5m US to \$1bn US. The interviews were conducted in the local language by native speakers and tended to average between 20 and 35 minutes. The results were then analysed by Jigsaw Research. The UK results in this report are a subset of those results.

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