KPMG Enterprise

Hidden growth within family businesses

Driving success without the fame

November 2016

In collaboration with:

EFB European Family Businesses

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Introduction

For over a decade scholars, politicians, economists and journalists have expressed growing interest in family-owned companies, evaluating their economic impact and dissecting their unique business models.

Much ground has been covered. Graphs and reports compare the performances of family and non-family companies of diverse sizes, sectors and regions, during economic ups and downs. Leading universities and business schools integrate family business courses into their curricula. European and international institutions are paying close attention to the sector. Finally, family businesses themselves have come out of shadows, unabashedly publicizing and highlighting their family roots.

Still, there is no generally agreed definition of the term, and only limited data is available on the sector's real economic weight. Many family business owners stay discreet about their success, rarely appear on front pages, and continue to be an enigma.

For many, the term family business immediately brings to mind the quintessential mom-and-pop. However family businesses are all around us – from small and mid-sized companies to renowned multinational corporations. One third of all companies in the S&P 500 Index are defined as family businesses.[1] Some 30% of all companies worldwide with over US$1 billion in sales are family-controlled enterprises.[2] Of the 250 largest companies in France and Germany, 40% are family-owned.[1] Many family companies do extremely well, and even better than their non-family counterparts.

Our research, conducted by KPMG and European Family Businesses (EFB), involved discussions with prominent family business leaders in various European countries.

We sought to shed light on some frequently asked questions regarding family businesses:

- What does success mean for them, and what is their ultimate strategy: stability; growth, or profitability?
- What drives their success, and what are the inherent barriers to growth?
- When growth is at stake, how do owners choose the right strategy and align the interests and needs of both family and business?

We trust that our report will provide you with insightful, interesting answers.

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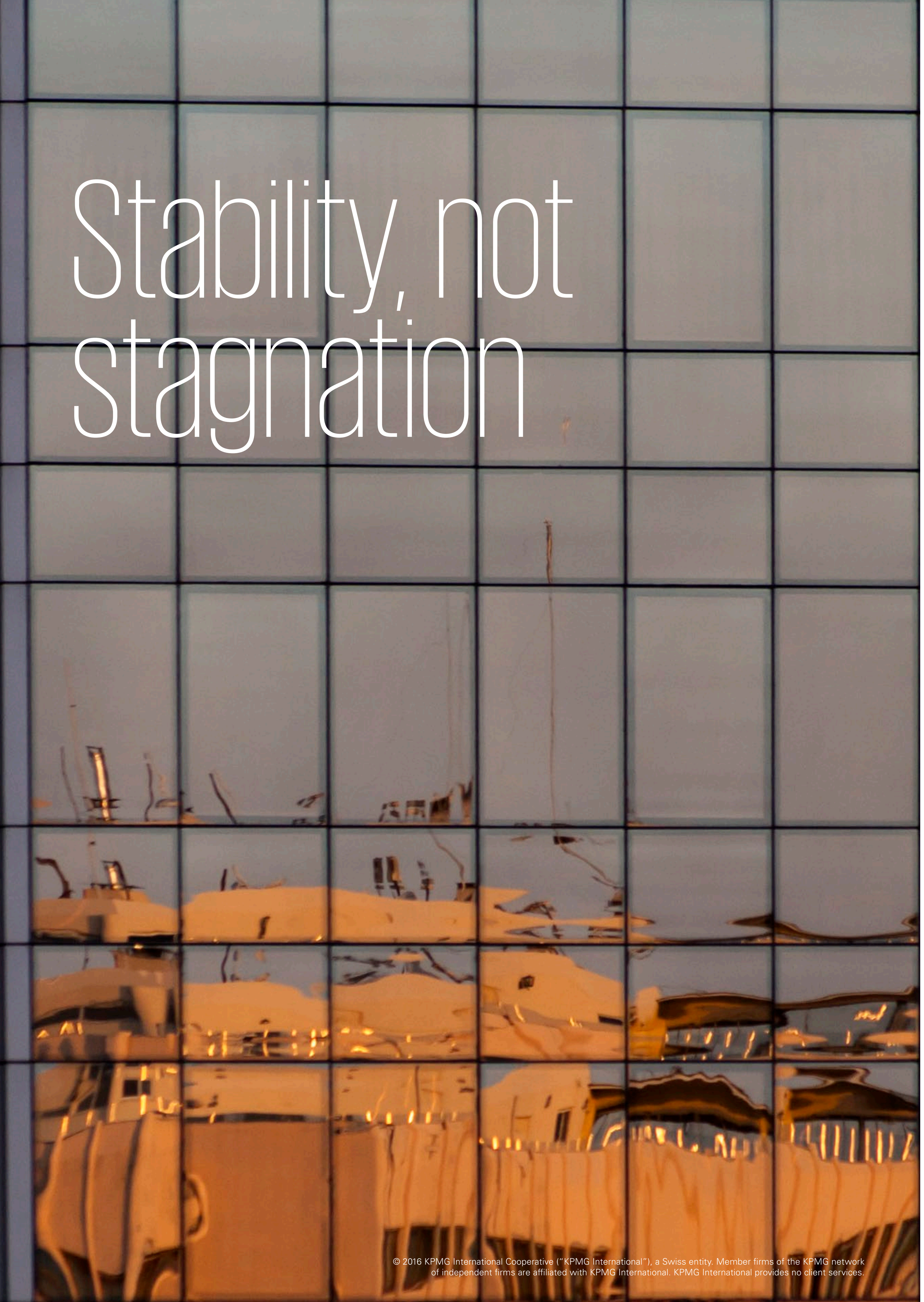
Sources: 1. *The five attributes of enduring family businesses*, McKinsey & Company, 2010
2. *What You Can Learn from Family Business*, HBR, 2012



Stability, not stagnation

Longevity, long-term outlook, and stability are traditionally cited among the specific attributes of family businesses. Although stability is sometimes mistakenly confused with stagnation, closer examination reveals that the two have nothing in common. To the contrary, growth is high on the agenda for family businesses, and long-term orientation tends to steer strategy.

Family legacy and strong personal attachment underpin the desire of family business owners to preserve their businesses for their heirs. Long-term outlook is their vision, longevity is their mission, and growth is their clear strategic choice. While growth is high on the agenda for family businesses, the way in which they achieve it has a number of characteristics unique to them.

Family businesses tend to project into a very distant future. In the words of one of our questionnaire respondents, *"we have a 50-year strategy", "after 160 years of existence, our objective is to see the company last for another 160 years", "the desire of our company is to exist in 500 years' time".* Their long-term outlook is measured in decades or generations, not quarters or months. Family-owned businesses need not fret about impressing investors with short-term performance figures. They can afford to slacken the pace slightly without sparking anxiety over momentarily lower or flat figures. Yield tomorrow is more important than return today. Family businesses are able to think and plan in the long run. They can take a longer-term strategic outlook, which is not always possible in other business models. This means they can make decisions that are right for the long-term even if that means sacrificing some short-term earnings.

The first key to sustainable success for family businesses is therefore **safer thinking** and moderate risk tolerance. However, these are balanced with an understanding that 'adequate' growth is necessary for the company to stay successful and competitive. As one Dutch respondent notes, *"if you are too focused on stability and security, it could hinder growth"*.

The second key is **prioritization**. Our recent European Family Business Barometer[3] demonstrates that, while 83% of family businesses plan to grow in the year to come, 57% cite improved profitability and 34% increased turnover as their top business goals. Both profitability and turnover growth are necessary for a company to survive and remain attractive to investors and analysts. Nevertheless, profitability is critical to a company's long-term survival.

> "After 160 years of existence, our objective is to see the company last for another 160 years."

Source: 3. *European Family Business Barometer — Successful & Resilient (fifth edition)*, EFB and KPMG, Sept 2016

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The key steps promoting the well-being and growth of a family business include:

A clear differentiation between family and business

Good governance

Parallel planning

Effective communication

Finally **long-term vision**, which could appear to be a barrier to growth, most likely spurs on family businesses. *"Dreaming in the long term and seeking resources in the short term"* is the way one Spanish respondent defines his business tactics. Long-term outlook is in the DNA of family businesses, the philosophy determining everything they do. It tends to steer strategy, enabling the development of good business planning, breaking down plans into small projects and taking one step at a time. Long-term outlook creates positive thinking, since businesses can grow in the long run without being beaten down by occasional downturns in performance. Family business owners can accurately choose the right strategy and prepare their companies for growth.

Preparing to grow

The determining feature of family businesses is their particular business model in which family and business interests are closely aligned and strongly intertwined. While owners seek business prosperity and family harmony, they are sometimes confronted with issues like differing positions of the shareholders, conflicts about business direction, and in the worst-case scenario, sibling rivalry, leading to shareholder exits or the (partial) sale of the company.

When growth is put on the agenda, business owners wonder how to make it happen, how to align business and family interests, and how to prevent those conflicts or differences of opinion that hinder growth.

As a first step, our respondents advise to **clearly differentiate between family and business** and not to mingle the two spheres. The business should be considered a business project, not a purely financial asset. The company's primary goal should be to serve customers, not the family. *"By serving its customers, it will eventually serve the family."* A business, with its vision and strategy targeting its well-being, should be separate from the family with its shareholders. The co-functioning of both is ensured by **good governance**. Governance mechanisms implemented should serve several purposes, such as separating ownership from management, setting up family and business rules, and defining dividend policy. With clear rules and guidelines as an anchor, family businesses can pursue their growth plans.

This separation does not mean that the business goes its own way. Ownership has special meaning in family companies, with a strong personal element. The family business should not be seen purely as a liquid asset, but as a property which is built and developed by the family over generations. *"Family and business are two different things, they are separate. Business is primary to the family. If business interests are put in first place, it will then ensure the family runs smoothly, not the other way around"*, comments one French respondent. His Spanish and Dutch counterparts concur: *"Conflicts occur when no distinction is made between the company and the family." "We have made an almost exorbitantly strict separation between family and business. From the beginning, the first focus was the business."*

Once rules are set up, the next step is to **communicate**. Shareholders should engage in constant discussion and *"open dialogue"* with the business to ensure they are happy with how the business is being run and what the returns are. Owners should have an *"adequate knowledge of the company"* and feel involved in its development. Our respondents confirmed that *"communication is key"* to satisfy all parties.

Good governance not only separates the functioning of family and business, but also helps both achieve their shared goal: to safeguard and increase family wealth. **Parallel planning** helps accomplish this goal. It is a proven tool to align the thinking and planning of both family and business into a comprehensive family business plan.

Parallel planning facilitates communication about business strategy and potential, which are in turn supported by the family's investments in human and financial resources.

Barriers to growth: fact or myth?

For family businesses, the future is not about sustainable growth. Although they are optimistic and united in their desire to succeed, there are still major challenges hindering their growth plans. Our respondents point to a number of issues that are potential obstacles to long-term success. Here we endeavor to determine which are specific to family businesses, and how they can be managed and overcome.

Poor strategy

Lack of business vocation, short-term vision, faulty planning, and poor management skills are often cited as major hurdles to business development. Growth requires energy, staffing, marketing, sufficient funds, and good planning. Poor strategy can figuratively kill growth plans.

There is no need to look for proof of how bad management can impact employees and a company's overall operations, lead to decreased profits, and even shutter a business for good. Examples abound, and concern family businesses as often as non-family ones. However in a family company, management is often *"closer to the staff"* and *"the employees have stronger confidence in management".* This can exacerbate the consequences of poor leadership on the company's future.

Below we examine other issues that are of much greater significance specifically for family businesses.

Talent shortage

The 'war for talent' is one such issue, and appears to have gained in significance over the past several years. According to the European Family Business Barometer[4], 37% of family businesses cite the war for talent as their top concern.

Family businesses usually rely heavily on their employees. Difficulties in attracting and retaining the best talents can definitely hinder performance. While no type of business is spared this issue, family company owners in particular often bemoan their negative image and perception on the labor market. Are their concerns justified?

Our respondents appear to dispel this myth. While a negative image might sometimes influence a company's ability to recruit and retain talent, more decisive factors are industry, location, and size. Some industries require highly specialized, hard-to-find skills *("for some qualifications it is not easy to find the right people").* Geographically remote areas are less attractive for job candidates and their spouses. *"Here the problem is that we are in a small city. Spouses do not want to come here and the staff lives far from the company."* Small businesses do not have big recruitment budgets, and are less visible to candidates.

Growth hurdles:

Poor strategy

Talent shortage

Unstable political environment

Lack of a successor

Source: 4. *European Family Business Barometer — Successful & Resilient (fifth edition)*, EFB and KPMG, Sept 2016

37% of family businesses cite the 'war for talent' and political uncertainties as their biggest challenges to growth and success[5]

Negative perceptions focus on lower salaries, the glass ceiling, nepotism, a lack of professionalism, and specific corporate culture. However, they are smoothed over by the generally improving image of family businesses, owing to the number of positive characteristics that underscore them such as genuine entrepreneurship, a dynamic spirit, efficient decision-making, faster acquisition of responsibilities, and stability *("people want stability and we can offer them stability")*.

Unstable political environment
Every business wants to operate within a stable and predictable political and regulatory framework. This is specifically true for family businesses, largely concerned about the current turbulence and poor political situation in Europe and other countries.

Although backed by solid financial reserves and able to obtain additional funding when needed, our respondents expressed that they could be thwarted by complicated regulations or legislation and unfavorable tax regimes. However, family businesses find ways to cope. *"Regulation is not in itself a barrier to growth"*, says one of the respondents. Others note that constant changes to labor and accounting legislation may be a *"thorn"* and *"cause us to spend more administrative time than expected"*, but they do not change growth plans. *"Regulation does not hinder me in my growth. It is not an obstacle, but a precondition." "The regulatory environment has not ever stopped us doing things – it has just made it trickier at times."* While developing domestic or overseas business, family businesses learn to operate under the reigning conditions. *"At most we desire a certain stability, meaning that the framework is clear and consistent. Nevertheless, the regulatory environment is not a key criterion in our evaluation of a market's attractiveness."*

When asked how tax regimes influence decisions about their company's future, responses were almost equally split between "greatly influenced", "somewhat influenced", and "not influenced at all". On the one hand, the lower equity resulting from high taxes could impair growth plans. On the other hand, a good understanding of tax regimes and timely preparation help companies to follow the chosen strategy. *"There are no consequences as long as the decisions in this regard are made at an appropriate time."*

What family businesses truly appreciate are corporate governance practices. Almost without exception, our respondents noted that these practices are helpful, that they generate *"trust and stability"* and serve as *"guidance to good practices"*.

Lack of a successor
The primary goal of family business owners is to preserve business so as to pass it on to their children and grandchildren. According to an oft-quoted statistic, only one third manage to do so in the first generation, under 15% by the second, and fewer than 5% beyond that.[6] We present below some successful family business practices that can help make the dream come true.

First, as mentioned above, there should be a clear separation between management and ownership. While the goal is to keep ownership within the family, the same should not necessarily apply to management. New family members should join the family business based on their professional skills and abilities rather than kinship. *"The next generation must ensure that they have the work spirit and networking skills needed to continue the business. They will need to understand that they will start from the first step and then progress. They will also need to always assume responsibility."* Family companies increasingly demonstrate this "neutral" approach when selecting candidates for management positions, and are increasingly hiring non-family executives. According to our recent European Family Business Barometer[6], 85% of family businesses agree that external managers are necessary for their company's success and 74% have already given non-family members managerial roles.

Misleading conclusions should not be drawn from this trend. There are many reasons to integrate non-family members into company management. Whatever the reason, this strategy helps keep the business in professional hands without losing family control. The solution suits all parties when next-generation family members choose a career outside of the family business, temporarily or permanently.

We also asked our respondents what they think of the upcoming generation, how their attitude and skills might benefit a family business or, to the contrary, hamper success and growth. Today's young people are well-educated and tech-savvy, with a strong entrepreneurial spirit, and an international mindset. This makes them a valuable asset for their family business.

At the same time, our respondents did express some concerns over the next generation's *"liberty"* and *"comfort behavior"*. They mentioned that today's youth is used to a certain comfort; lacks passion, motivation, and tenacity; and is less attached to the business *("they come and they go")*. In addition, while the national education system generally imparts a good theoretical and technical foundation, it does not provide sufficient practical skills in terms of communication and leadership. These findings, however, could be attributed to the ever-present generation gap, and the fact that we interviewed a senior generation. Our report withholds from passing any judgement on younger generations.

74% of family businesses currently have non-family executives[5]

Sources: 5. *European Family Business Barometer — Successful & Resilient (fifth edition)*, EFB and KPMG, Sept 2016
6. Family Firm Institute

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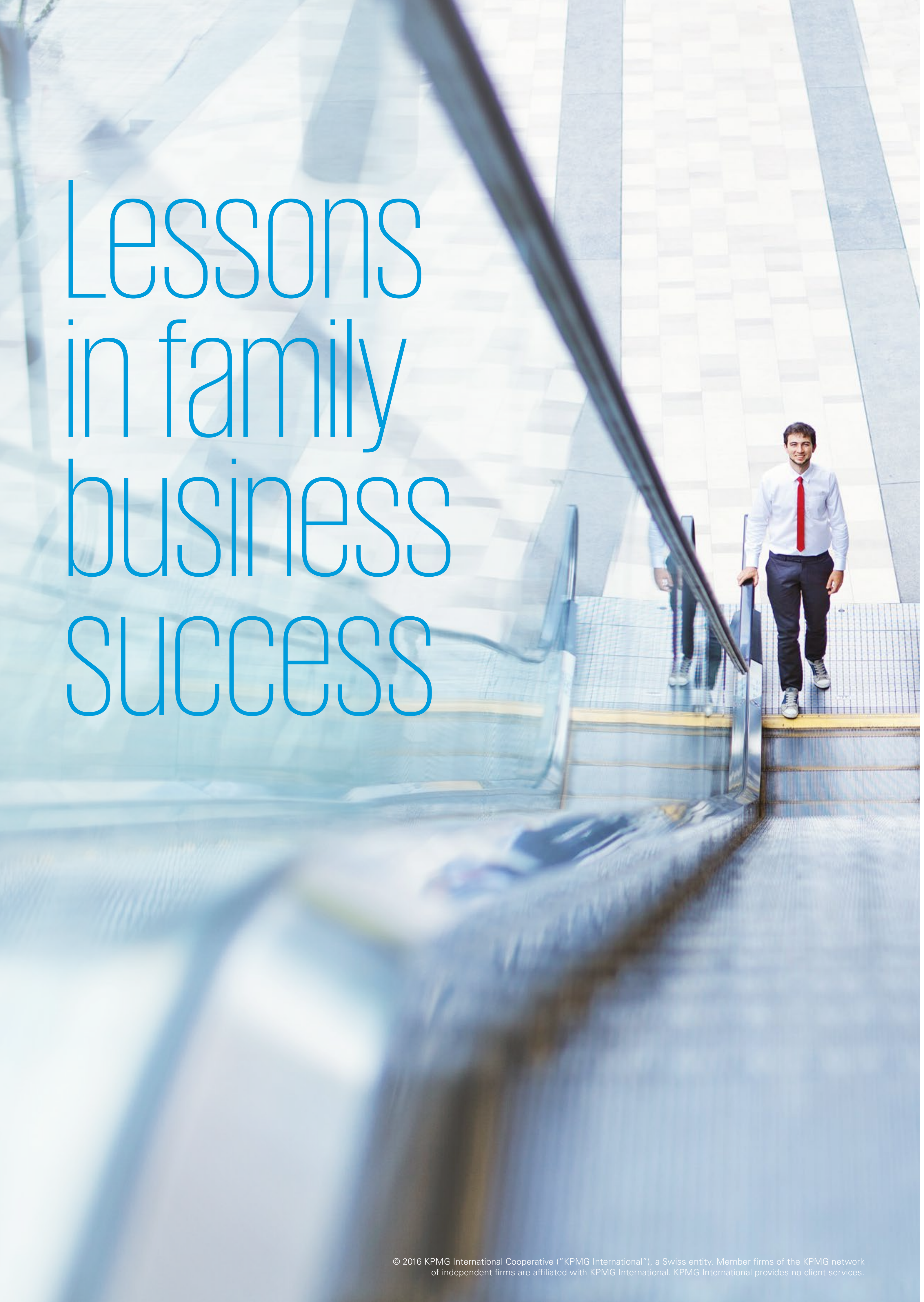
Lessons in family business success



The ability to innovate is one of the keys to competitiveness in the current economy. Together with international expansion, innovation is commonly considered a major success driver. In pursuing long-term growth, family businesses do not overlook either of these opportunities in their strategic and investment plans. Additionally, they stay true to their principles in everything they do.

True business success cannot be measured in immediate profits alone, but rather in the value a business brings to its customers. Real value only becomes apparent over time. This applies to family-owned companies more than to any other type of business, given their pursuit of longevity and success over a long period. By constantly innovating and *"staying ahead of the curve"*, family businesses manage to succeed and grow over decades. *"Innovation is crucial to stay first in the market"*. our respondents affirm. *"Innovation is crucial for growth in the future. Without innovation – no growth"*.

Constantly innovating

At first glance it may seem like the family business model would be the most hampered by traditional thinking, and that owners' strong desire to innovate might not be enough. But in reality, quick, innovative thinking is more viable in a family business than in many other companies, owing to several unique factors.

Their long-term vocation makes it easier for family business owners to make decisions on innovation. Return on investment is not immediate and requires patience. *"The long-term outlook of a family business could entail a greater desire to enter a long-term project, such as R&D"*. Family members managing the business are empowered to make decisions that promote the company's long-term interests.

There is also a *"natural generational input"*. Often, at least two generations are involved in the business in one way or another, which leads to a constant exchange of ideas. The older generation may follow a traditional business approach, while the new generation feeds the business with new ideas.

Finally, a strong culture of trust and high flexibility allows new ideas to flow freely and be implemented quickly: *"Flexibility or a constant willingness to change is the key factor." "Our ability to innovate is very dependent on culture. There is flexibility and openness required."*

Innovation is among the top investment priorities for family businesses[7]

Three keys to long-term success:

Innovate

Expand internationally

Stay unique

Source: 7. *European Family Business Barometer — Successful & Resilient (fifth edition)*, EFB and KPMG, Sept 2016

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Going abroad

Family businesses have proven their ability to seize global economic opportunities and successfully develop on the international markets. According to our recent European Family Business Barometer[8], 76% of family companies operate abroad. The majority of our questionnaire respondents adhere to the same strategy. They mentioned that their choice to enter new markets is determined by business opportunities and needs, and has little to do with being family-owned. However, there are some unique characteristics in the way they go about it.

Flexibility and agility enable family businesses to take advantage of globalization and seek opportunities beyond the domestic market. *"I notice an opportunity and I can be there next day. This is the greatest advantage that we offer."* Some respondents add that while the decisions are taken quickly, the pace of implementation does not always follow. *"Family businesses are more cautious when moving abroad."*

Family businesses rely heavily on local partners and family networks. *"Being in a 'circle of good repute' means that they can easily and rapidly establish contacts in different countries where they want to carry out business."* If a company seeks to 'test the waters', it may first look to family for 'volunteers' before turning to local talent to head up local branches.

Another unique characteristic is the choice of market. Small and medium-sized family businesses often prefer niche markets that are complicated for big multinationals. *"The company's strategy is to compete in niche markets which are unattractive to multinational companies." "Niche markets are interesting for us, because there are not any big plant manufacturers. They do not have the flexibility for niche markets."*

Staying unique

Family businesses know how to be successful. They live long, demonstrating positive growth and strong resistance to economic downturns. Their advantages are manifold: long-term vision, patience for returns, agility, flexibility, strong family values, and a culture of trust. However these characteristics alone do not ensure success. Strong leadership and commitment to core principles – in other words, the courage to follow their own way – build success. *"Family businesses have certain attitudes on various topics: towards risk, successors, political developments, and strategy. This distinguishes them from other businesses which often chase fads. Today's successful companies are so successful because they have followed their own experiences and principles".*

76% of European family businesses operate abroad

Source: 8. *European Family Business Barometer — Successful & Resilient (fifth edition)*, EFB and KPMG, Sept 2016

"Today's successful companies are so successful because they have followed their own experiences and principles"

Conclusion

Stay unique, stay successful!

Family businesses are focused on growth, and they are growing. At the same time they stay discreet, preferring to reap the fruits of their labor with family and co-workers rather than making bold press announcements. Because of this modesty, the success of family businesses can often go unnoticed, and their real economic importance is underestimated.

Family business owners take a careful approach to risk and grow intelligently. They prefer profitability to turnover increase and deferred yield to immediate returns. They treasure stability and actively reinvest dividends. These tactics provide them with solid internal funds and independence, allowing them to feel secure during economic downturns and to develop new projects.

There are some serious hindrances to the success of family businesses: unstable politics and regulation, talent shortage, poor strategy, and a lack of successors. Business owners learn to navigate through these challenges. They stay positive and optimistic, boost professionalism at their companies, and remain true to their principles and values.

Family business owners naturally multitask, simultaneously overseeing business prosperity and family well-being. However all respondents unanimously agreed that the two should not mix. Business should be business, and family, the shareholding family. While family and business are obviously intertwined, this is achieved by good governance rather than an attempt to adjust business interests to family interests.

"Family members should enjoy the benefits of the growth of the business to a reasonable extent".

The respondents stated that success requires courage: to constantly try new things, blaze new paths, avoid ruts, and maintain the entrepreneurial spirit across generations. *"The entrepreneurial family must remain as such at all costs, and not view the company merely as a financial asset. If the company is viewed as an asset, the family is an investment-minded family, not an entrepreneurial family."*

Family businesses are on to a good thing.

Thank you

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About the report
This report is based on the reflections of 26 prominent family business owners in eight countries: France, Germany, Luxembourg, Malta, the Netherlands, Slovakia, Spain, and the United Kingdom. We gathered their thoughts in qualitative individual interviews conducted face-to-face or by telephone.

The figures cited are based on the findings of our recent publication, the fifth edition of the European Family Business Barometer:

European Family Business Barometer
Five editions of this study have been conducted from 2013 to 2016 in partnership with the EFB (European Family Businesses). The study delivers insights into the confidence levels of family businesses in Europe, the challenges they face, and the changes they need to overcome.

The fifth edition, *European Family Business Barometer: Successful and resilient*, was released in September 2016, and was based on 959 completed questionnaires received from 23 European countries.

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About EFB
European Family Businesses (EFB) is the EU federation of national associations representing long-term family-owned enterprises, including small, medium-sized and larger companies. The organization was created in 1997 and represents €1 trillion in aggregated turnover, nine percent of European GDP.

EFB's mission is to press for policies that recognize the fundamental contribution of family businesses in Europe's economy and create a level playing field when compared to other types of companies.

www.europeanfamilybusinesses.eu

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We help privately owned businesses achieve their growth ambitions by combining deep business and industry expertise with a dedicated focus. Specifically designed for mid-market businesses, KPMG Enterprise offers you a private business advisor, who works alongside you to help your business succeed. Passionate about getting to know you and your business, we have a simple philosophy: we look to add value both through the insight we bring and via our extensive broader network and resources, connecting you to market-leading insights, ideas and people.

KPMG Enterprise Global Centre of Excellence for Family Business
From the boardroom to the kitchen table, KPMG Family Business advisers share practical advice and experienced guidance to help you succeed. To support the unique needs of family businesses, KPMG Enterprise manages a global network dedicated to offering relevant information and advice to family-owned companies. We understand that the nature of a family business is inherently different from a non-family business and requires an approach that considers "the family component".

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