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PwC Family Business Survey 2010/11

A US perspective

What family businesses have to say about their current conditions, challenges and intentions as they look to grow again

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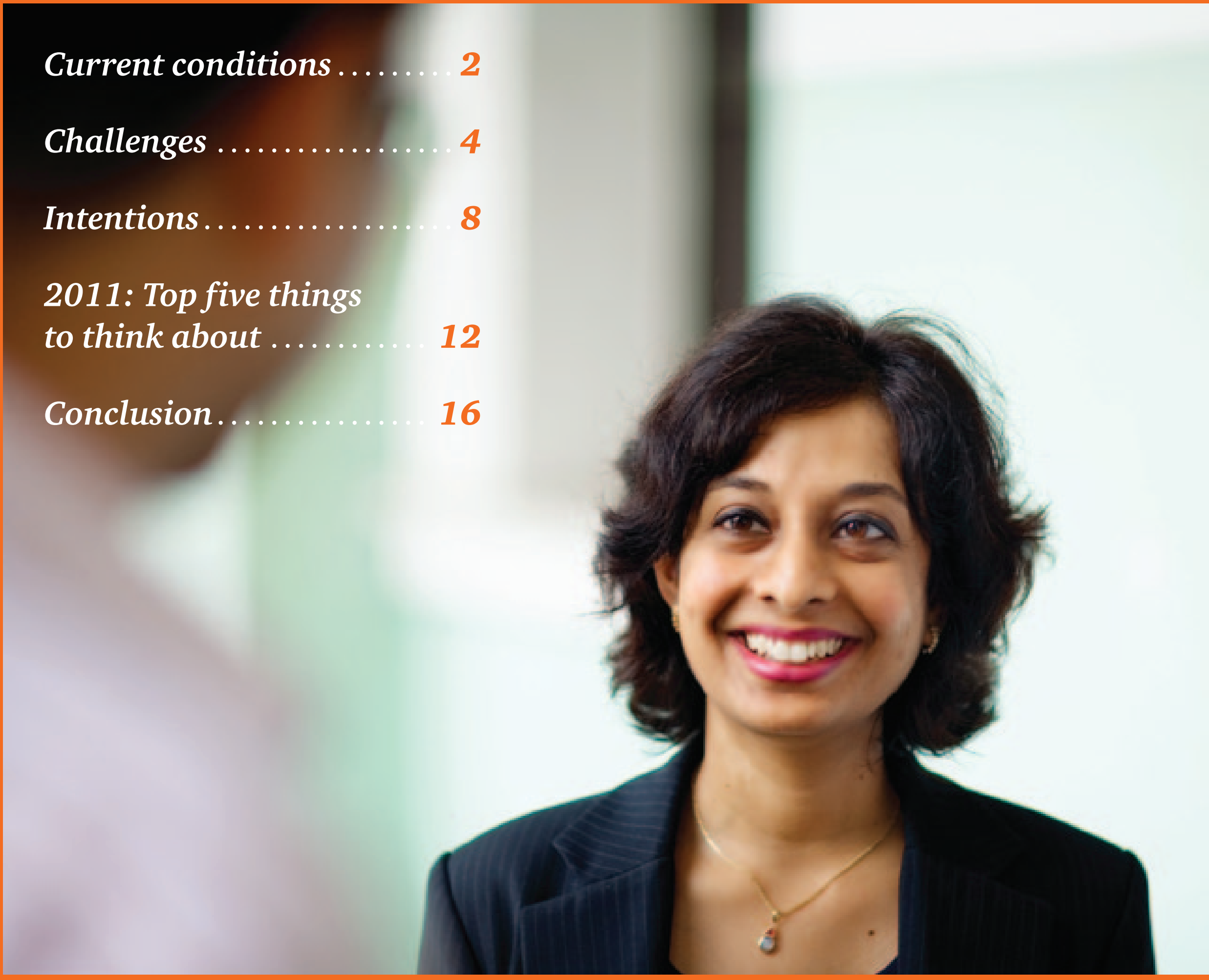
Introduction



In this companion piece to PwC's global Family Business Survey, we look at what US family businesses have been doing and thinking since we last conducted our survey in 2007.

Much has happened in the interim, most notably the global economic crisis. Three years on, US family businesses are both apprehensive and hopeful.

Where family businesses' optimism is perhaps most evident is in their plan to make growth and expansion their chief business strategy (70%) over the next 12 months. But uneasiness about the future lingers: Just slightly more than half of the US family businesses we spoke with intend to hand over their business to the next generation — considerably less than in our 2007 survey (72%).

Whether this is the beginning of a trend or simply a temporary reaction after a tumultuous couple of years is something we'll have to determine once we conduct our next family business survey. Meanwhile, the current picture presented by this year's results is of businesses that have successfully weathered the economic storm (most are in a strong financial position) and are now cautiously considering where to place their next big bet.

In seeking a competitive advantage, family businesses will need to place their next big bet on what will bring sustained growth. And that may require a departure from how they've done things before. So while they'll still have to address perennial issues — taxes, business succession, human capital, growth — they'll need to view those focal points through the lens of change, both recent and incipient.

This entails taking into account not only new market dynamics, but also ever-emerging technological innovations and evolving business models. Legacy IT systems, for instance, might no longer be adequate for a company that wants to be nimble in today's fluid business environment. Similarly, home-grown expansion as a key business strategy might bear rethinking by family businesses, as global markets continue to outpace the United States in economic recovery.

Our US report strives to bring these shifting dynamics into sharper focus by summarizing key survey results, including those regarding your peers' current conditions, challenges, and intentions. We hope that you'll not only find the results illuminating, but also use them to generate an open discussion among the members of your family business — which has been a main objective of this survey from the start.

"We are trying to gauge the economy's direction so that we can decide what to do now to take advantage of things 12 months out."

US family business owner

Current conditions

While many of the family businesses we surveyed exhibit a fair degree of post-crisis wariness, few seem to be dwelling on the crisis itself at this point.

Of the family businesses we spoke with, only 12% anticipate making major changes to their business model as a result of the financial crisis. Quite possibly most of those businesses already made the needed modifications a year or so back. Nearly all of the businesses we surveyed, however, say that if future changes become necessary, they'll have enough cash to finance them.

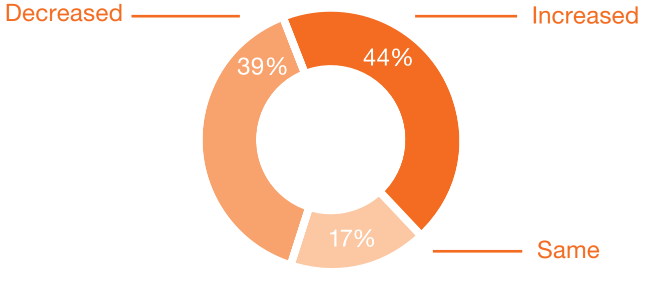
Indeed, 76% say they have access to surplus cash, though what they'll do with it remains to be seen. That they've yet to spend the money does not appear to be for lack of ideas. Eighty-one percent of family businesses have a strategic business plan in place, and most have reviewed or updated it in the past 12 months. It seems, however, that many business owners are waiting for greater market certainty before they fully execute their plans. Almost all the family businesses we spoke with say they're concerned about market conditions — markedly more so than their global peers (88% vs. 68%).

This disparity between US family businesses and their global counterparts could be a function of where the US survey participants do business. Over half of them sell their goods and services solely within the United States, where consumer spending remains tight. Little disparity, on the other hand, arose between US family businesses and their global peers when it came to demand for products/services — with a greater percentage of both US and global businesses reporting an uptick versus those reporting a decline.

As would be expected, though, the percentage of companies reporting an uptick is not as large as it had been when we last conducted our survey. Two-thirds of US family businesses reported an increase in demand in 2007, whereas only 44% did in 2010.

Despite this overall decline in demand, 71% of US family businesses say they're very competitive compared with market leaders, which is only slightly lower than in the last survey (74%), when market conditions looked considerably rosier.

Figure 1: Demand for family businesses' products and services over the past 12 months:



Challenges

Looking out: Top external challenges

For all that US family businesses consider themselves very competitive, they also cite competition as among the top three external challenges they face today. That said, they regard competition as less of a challenge now than in 2007 (21% vs. 34%) — possibly because key competitors in the pre-crisis landscape are no longer in business.

Market conditions topped the list of external challenges (88%). Nearly one-third of family businesses also say that government policy poses a challenge. Tax policy, in particular, is of concern, with 76% of surveyed companies saying that the simplification of the rules governing corporate taxes and/or the lessening of the tax burden is "very" or "quite" important to them.

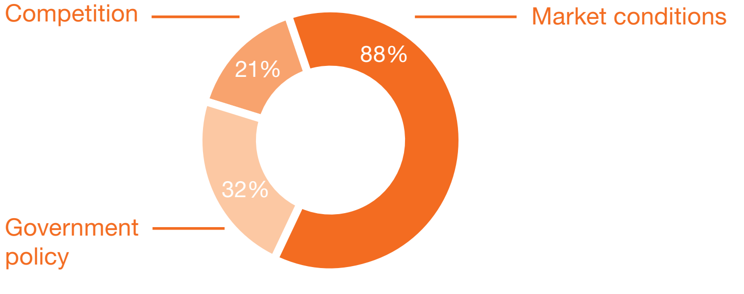
As of this writing, the Bush-era tax cuts are due to expire at the end of 2010 (barring legislative action), to be followed by the healthcare act's tax increases on high-income individuals, starting in 2013. Mitigating the effect of the scheduled tax increases on capital gains, qualified dividends, and other income — along with the impact of potential estate tax increases — will require careful planning on the part of family businesses.

For growth-oriented companies, taxes and regulatory issues around the globe also merit careful attention. Nineteen percent of survey respondents consider international tax regimes a top challenge. This percentage may rise as family businesses increasingly look beyond the constrained US market to seek revenue opportunities in emerging and fast-growing markets (EFGMs) abroad.

"We're competing against companies who are desperate, owing to the economic times. That is tough competition. It requires being creative."

US family business executive

Figure 2: Top external challenges* for US family businesses over the next 12 months:



*Apart from demand and issues related to sales and orders

Looking in: Top internal challenges

Interestingly, finding skilled personnel was the chief internal challenge cited by family businesses in this year's survey. Indeed, concern about finding qualified workers is slightly higher now than at the time of the last survey (52% vs. 49%), despite today's high unemployment rate. This suggests that the majority of workers who were laid off over the past couple of years do not have the skills currently sought by companies that have weathered the economic storm and are now looking to grow again.

So what skills are they seeking? Although the family businesses we surveyed are not heavily concentrated in the service sector, the survey data suggests that the skills they're looking for tend in that direction. For instance, family businesses are planning considerably greater investment in areas such as IT, marketing, and sales than in supply chain, transport, and logistics.

The construction and industrial manufacturing businesses we surveyed, therefore, may be less in need of crane operators and metal fabricators than they are in need of IT technicians and Web-savvy marketers — people whose skill sets are, by the nature of their fields, constantly evolving and hence less easy to come by.

Indeed, we are seeing companies increasingly look to technology as a strategic asset and competitive differentiator. So it comes as little surprise that as family businesses wind down core cost-containment efforts, they're beginning to up their investment in IT and Web-focused activities.

With new technological innovations come new security considerations, and so businesses will also need to find people who have the right expertise to address those issues. It stands to reason, then, that 79% of survey respondents say they plan to invest in human resources and training over the next 12 months.

Figure 3: Top areas where family businesses say they'll invest over the next 12 months to improve productivity and overall competitiveness:

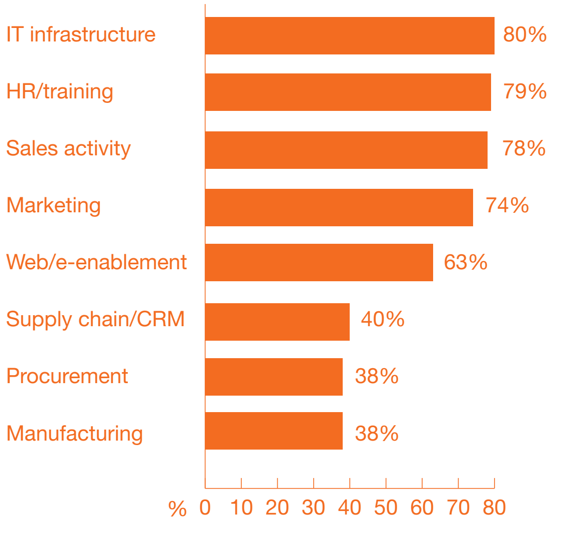
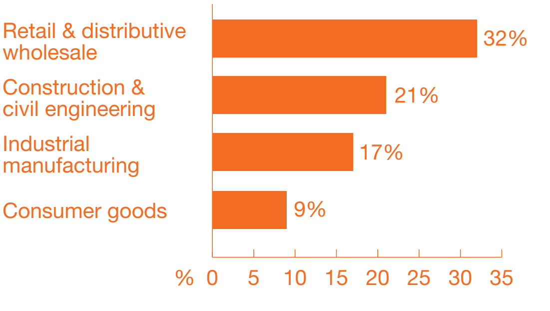


Figure 4: How the family businesses we surveyed described their industry/sector:



"We're starting to see smaller, more frequent orders. These volumes will be more expensive to pick, pull, and ship."

US family business owner

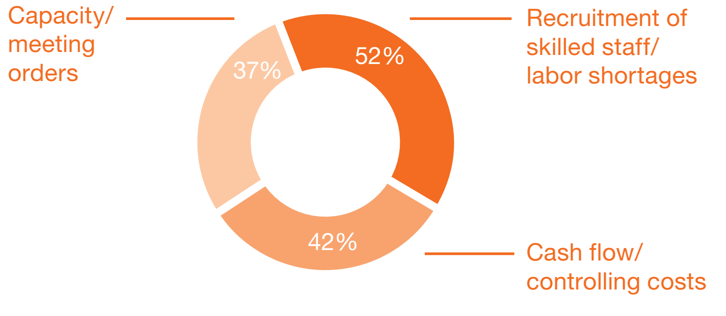
Other top internal challenges cited by family businesses include managing cash flow, containing costs, sustaining sufficient capacity, and meeting demand.

We've seen how running leaner these past couple of years has caused inventory levels to become quite low at some family businesses. Those companies may now find themselves hard-pressed to ramp up inventory levels quickly enough to keep pace with the business's growth and expansion objectives, particularly in light of labor-shortage concerns.

At the same time, there is the ongoing desire to control costs. One-off cost-containment efforts that companies made early in the recession may, at this stage, need to be reinforced by more-sustainable measures. One way businesses have begun doing this is by outsourcing back-office functions through the use of shared services centers. Accounts payable, for instance, is an area where we're seeing this happen — a new trend in the private-company sphere.

Companies may also start to explore new technologies such as cloud computing, which can be enlisted to help with — or even take over — functions like customer-relationship management (CRM) or payroll administration. Family businesses have traditionally been reluctant to take such cost-cutting routes, since doing so often entails laying off employees. However, the savings these avenues offer may begin to tilt the scales as family businesses weigh new options in an increasing effort to keep overhead down and to get the most value out of their workforce (e.g., by redeploying workers in areas more critical to the business).

Figure 5: 12-month outlook — Top internal challenges* for US family businesses:



*Apart from demand

Intentions

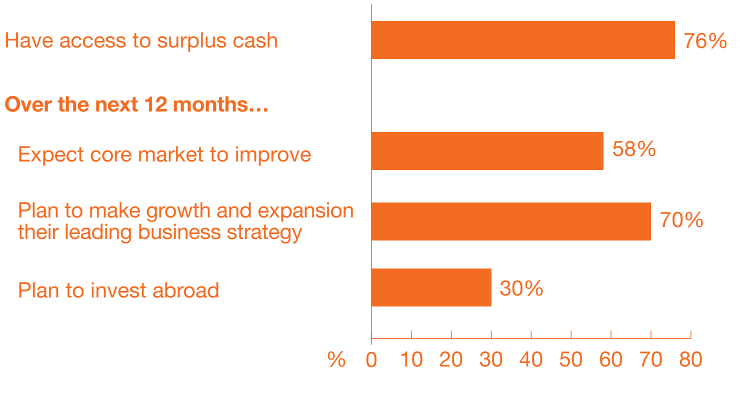
Looking ahead at the next 12 months, 58% of the family businesses we surveyed say they expect their core market to improve.

An even greater percentage plan to make growth and expansion their leading business strategy (70%). Thirty percent intend to invest abroad — up from 21% three years ago. That number may take a bigger leap between this survey and the next if the economic recovery in the United States doesn't quicken its pace. We've found that for leading US private companies, international investment has provided an economic buffer over the past couple of years.[1] More family businesses may start to follow the example of these other companies as key foreign markets continue to rebound faster than the US market.

"The strength I admire most in my key competitor is their geographic coverage — the ability to service customers abroad."

US family business owner

Figure 6: Family businesses are poised for growth.



1 See PwC's quarterly, survey-based *Trendsetter Barometer™ Business Outlook* reports: http://www.barometersurveys.com/trendsetter.

Some family business owners, however, may be less focused on the speed of the economy's recovery and more concerned with its sustainability. While 72% of the family business owners with whom we spoke in 2007 said they intended to pass their business on to the next generation, only 55% echoed that intention this year — hinting at reservations about long-term growth prospects for the economy and the ability of family businesses to thrive in it.

The business owners voicing these reservations are not at the helm of fly-by-night companies. Sixty-three percent of our survey respondents have been in business for over 50 years; 37% have been operating 20 to 49 years. And so they've navigated through down markets and recessions before. Arguably, though, this latest economic crisis may be the toughest one they've dealt with to date. A good number of them have seen their family wealth diminish in the process. Only 62% of the family businesses we surveyed say they have sufficient resources to divide their assets fairly between all their heirs.

> ***"We are creating another generation of people who can carry this company on, and they might not be family members."***
>
> **US family business owner**

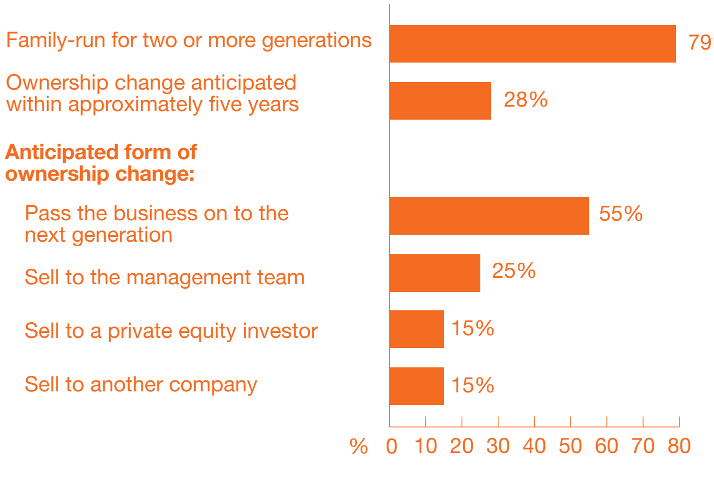
Most family business owners, however, do not intend to sell or otherwise hand over the reins to their business imminently — only one-quarter anticipate ownership to change within the next five years. The majority say they have a succession plan for key senior roles. Forty percent, however, report having no such plan in place, which is consistent with the last survey's findings, but worrisome, since lack of a plan increases uncertainty about the future. That, in turn, can adversely affect a company's growth.

Conversely, 73% of the family businesses we surveyed have made provisions for dealing with business and family issues in the event of the untimely death or incapacity of key managers and shareholders. One reason for this higher percentage may be that owners of family businesses — particularly large ones — recognize that with the resumption of the pre-2001 estate tax rate in 2011 (barring legislative action), they may have to contemplate new strategies for mitigating their tax liability — for instance, establishing partnerships, limited liability corporations, or life insurance trusts.

In many cases, provisions for dealing with the untimely death or incapacity of key managers and shareholders consist of informal, undocumented plans. Such plans should be put in writing, reviewed periodically, and updated as needed. The same holds true for succession plans.

Most of the businesses we surveyed have been run by the family for multiple generations — 46% over three or more generations, and another 33% over two generations. Our experience is that the transfer of family business ownership across generations is generally most successful when a carefully considered, well-documented, and routinely updated plan is in place — one that is communicated to all key stakeholders in a timely fashion. The fewer surprises, the smoother the transition.

Figure 7: The life cycle of a family business:



2011: Top five things to think about

While family businesses have a wide variety of important matters to think about, depending on their industry, size, region, and other multiple factors, our work with family-owned enterprises — coupled with the survey findings — suggests that the following five areas deserve special focus in the upcoming year:

1. Growth abroad
2. Succession planning
3. Taxes
4. Talent
5. Business model & operating structure

Growth abroad

As family businesses start to put their cash reserves to work, they may want to consider either exploring or more aggressively pursuing growth abroad. We've seen a number of private companies do this in the face of limited growth opportunities here at home. In fact, our ongoing research has shown a definitive split between private companies that operate abroad and those that do not.

Those marketing internationally in recent years (particularly in emerging and fast-growing markets) have consistently projected higher revenue growth rates than their domestic-only peers, with our latest reported figures[2] showing 12.2% revenue growth for international marketers versus 7.7% for domestic-only companies. International marketers also expect 19% of total revenues to come from international sales over the next 12 months. More of these companies are planning major capital investments compared with their domestic-only peers (43% vs. 24%) and increases in operational spending (76% vs. 53%), as well as intend to make new business acquisitions (21% vs. 6%).

As it becomes increasingly hard for some family businesses to grow sufficiently from home-market revenue alone, we may see them start to follow their private-company brethren in pursuing business abroad. Chief among the things family businesses will want to consider in exploring expansion abroad are regulatory, tax, and legal issues. Understanding these matters before going into a new market is critical to achieving success there.

To sustain that understanding, companies should establish relationships with government officials in the foreign markets where they're operating. Leveraging your global network (e.g., suppliers, shared services centers, professional service providers) can be a good way to obtain introductions to such officials. It can also be an effective means of accessing key entry points to the global markets — for instance, through the formation of strategic alliances or joint ventures with well-situated business partners.

2 PwC's *Trendsetter Barometer™ Business Outlook 3Q 2010*. See http://www.barometersurveys.com/trendsetter.

Succession planning

Good communication among members of family-run businesses and the need to groom a successor are perhaps more important now than ever before. Ongoing economic, tax, and legislative changes make it unwise, if not impossible, to let a business run on auto-pilot these days. Whoever takes the helm once the current leader steps down will need to be sufficiently trained in the ways of the business, the company's industry, macroeconomics, and tax policy. He or she must also be prepared to react swiftly and decisively in the event of a crisis. These skills cannot be acquired overnight.

By choosing a successor sooner rather than later, the owner signals to family members, other key stakeholders, and the market the intention to keep the business going — an important message to broadcast in times of economic uncertainty. Selecting the next leader, and then communicating that decision, also helps to prevent surprises that could be disruptive to the business. Ultimately, timely succession planning will increase the likelihood that the business and its value will endure well beyond the leadership transition.

Taxes

With the scheduled expiration of the Bush-era tax cuts at the end of 2010, the favorable 15% tax rate for qualified dividends will go away — meaning that all dividends will be taxed at ordinary income rates (up to 39.6% for some people). Family-owned businesses and their members will need to plan accordingly. They will also have to plan for the return to the maximum federal estate tax rate of 55% in 2011 (with an estate tax exemption of $1 million). This is a significant departure from the 45% maximum rate (and $3.5 million exemption) that applied to estates of people who died in 2009.

Also, business owners who are thinking of selling their business or transferring it to the next generation in the near future will need to assess the likely tax liability. This will require having the business valued professionally. Of the family businesses we surveyed, 47% hadn't had their companies valued domestically in the past 12 months (only 11% had their companies valued internationally).

This helps explain why only half of family business owners know how much domestic capital gains tax they or their companies might be liable for (only 10% know about the international tax implications). Sixty-two percent are unaware of the inheritance taxes their heirs might have to pay. What family businesses don't know, they can't plan for. Addressing such oversights could lead to considerable savings.

Talent

Almost all the family businesses we surveyed say the primary way they retain key talent is by paying them well (94%). Most have had incentive plans in place for more than two years; 88% say the plans have had a positive effect. The annual bonus was the favored approach (91%), followed by deferred bonuses (30%) and share plans other than stock option plans (26%). Only 5% have stock option plans in place.

Survey respondents say they also retain employees by giving them challenging job opportunities (90%) and applying good management techniques (89%). They've put less emphasis on career progression (64%) and work/life balance (66%). As family businesses compete for top talent, however, they may find they need to give these last two areas — career progression and work/life balance — greater attention, since they're becoming increasingly important to today's workforce.[3]

Admittedly, this might be hard to do for smaller companies, particularly with respect to career progression. Plus, the most desirable positions are often reserved for family members — though not always: 37% of our survey respondents say that key senior management roles would not be assumed by family members after the current people in them vacate their spots. Once an outside person takes one of those positions, however, he or she might find there's no room to move up. Ultimately, creative solutions may have to be found if family businesses want to attract and keep the best people.

3 This has been evidenced in recent research reports, including *Meeting Tomorrow's Workforce Needs: Flexible Workforce Arrangements*, PwC, 2009, and *Retaining Key Employees in Times of Change*, McKinsey Quarterly, McKinsey, 2010.

Business model & operating structure

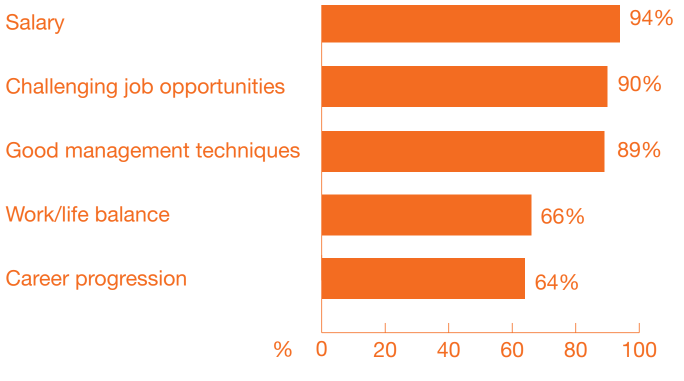
Although most of the family businesses we surveyed don't plan to change their business models in the near future, that approach might bear rethinking. What with uncertain economic conditions and the deficit-driven tax policies that are likely to emerge in coming years, it would be prudent for businesses to revisit their business model routinely.

Part of that review should involve considering whether a business's current operating structure is either appropriate or optimal. We've begun to see some family businesses abandon their current structures for alternative ones, in anticipation of higher tax rates or to position themselves for the possible pursuit of an exit strategy — with the goal of enabling their families to realize the greatest value for the business.

For instance, certain family businesses that are in the form of "S" corporations may want to consider converting to "C" corporation status, since the usefulness of the pass-through nature of S corporations will be reduced by upcoming increases in tax rates for personal income. Other reasons family businesses might contemplate such a conversion include the desire to have wider access to financing sources in a still-tight credit market and the wish to have greater ability to retain earnings in the business.

As of late, we've also seen family businesses consider exchanging a corporate form for that of a limited liability company (LLC) — this in response to watching the worth of their businesses decline in the economic downturn. Such businesses find themselves sitting on significant unused losses or strapped with depressed business-asset values. In these cases, the tax and transaction costs of a corporate liquidation might be reduced to a point where conversion to the more flexible LLC structure is a viable option for certain family businesses.

Figure 8: Measures that family businesses have in place to retain key talent:



Conclusion

Despite a turbulent few years between this survey and the last one, family businesses remain a substantial force in both the US and global economies.

Seventy percent of our survey respondents say that being part of a family business has helped them through the economic crisis. We have little doubt that it will also help them move forward in the ongoing economic recovery.

To that end, management teams may want to add to their agenda a focused discussion around the following questions:

- Have we made the necessary big bets to set us on a course of sustained high performance over the next five years?
- What is our next growth engine?
- What changes do we need to make to achieve our business strategy?
- Will the big bets we've placed give us a competitive advantage that our peers can't replicate?
- Have we sufficiently gauged our risk exposure and how to mitigate it?

Contemplating these questions and then formulating the answers should help family businesses navigate successfully into the next decade of the 21st century — and beyond.

"We can do anything. We are not a big bureaucracy. We're large enough that we have some economies of scale but still small enough to be more nimble and creative than the largest of our competitors."

US family business owner

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About the survey

This PwC Family Business Survey report highlights the views of 89 US companies, that were interviewed June through August of 2010 via a 20-minute telephone discussion. The US portion of the survey is one component of PwC's global survey of over 1,600 companies in 35 countries. The research was coordinated by the PwC International Survey Unit, Belfast, our global center of excellence in market research, which designed the questionnaire in conjunction with PwC's family business experts.

Our US report reflects the collective effort of PwC's Rich Stovsky, Alfred Peguero, Cristina Ampil, Robert Farr, William Zatorski, Amy O'Brien, and Cecily Dixon.

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[1] 2009 Forbes America's Largest Private Companies List