Family Business Survey 2018

The values effect

How to build a lasting competitive advantage through your values and purpose in a digital age.

pwc

Introduction

In recognition of the exceptional value that family businesses and private companies contribute to the economy in Kenya and the East Africa region, PwC has published our third biannual Family Business Survey, Kenya edition. This year's survey focuses on values and how clear, well-integrated values have the power to transform family businesses.

As PwC, we also have strong values and they inform our service to clients and outreach to business leaders like you. Our global PwC values – Act with integrity, Make a difference, Care, Work together and Reimagine the possible – are how we see ourselves and how we communicate a shared PwC culture.

We are committed to working with our clients to develop solutions with proven results and a strong track record of success. Our practitioners are trusted business advisors who bring a wealth of experience to our clients, as well as relatable experience and insight.

This publication, based on conversations with family business owners, is an effort to help you understand some of the trends affecting family businesses in Kenya. Private companies represent a very broad market including established family businesses, family managed or controlled businesses and the influential individuals who lead them. On the horizon in Kenya, we are seeing inter-generational transfers of wealth, the prominence and growth of private companies cross-border and increased regulatory pressure on companies of all kinds.

In this publication, our practitioners, senior members of Kenya's family business community and representatives of related industries share their insights, which I hope will resonate with you. The survey itself is the product of many respondents' time and effort. We are grateful for their contributions.

Our team is ready and prepared to help you achieve your business goals. If you have any questions or if you need help in a particular area of your business, please reach out to any of the PwC people profiled in this report. You are also welcome to contact me or our Private Company Services partner leader, Michael Mugasa, at any time.

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Foreword

In a fast-changing and challenging business environment, family business owners are introspecting on their legacy, purpose and what makes "values" count for their businesses. Digital technology is disrupting businesses; sustainability is becoming key to the conduct of business; winning trust is more important than it's ever been; and millenials present an enduring demographic change. In this third edition of the results of our biannual family business survey in Kenya, we focus on the significance of "values and purpose" as a driver of success in family owned businesses.

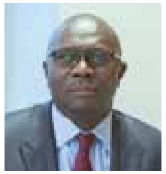
We believe family businesses - built around strong values and with an aspirational purpose - have a competitive advantage in disruptive times. It's long been recognised that a family firm - ranging from a global enterprise to a business in a small community - is more likely than other companies to treat each day's activity as an investment in the long-term, prioritising broad stakeholder interests over the short-term earnings cycle.

Overall, our respondents in Kenya expressed continued optimism about future growth, but also increasing concern about corruption in the countries where they operate, attraction and retention of talent, prices of energy and raw materials, international competition, innovation to keep ahead and regulation. This suggests a need for continuous strategic thinking to stay ahead of the curve!

For this report, we surveyed 2,953 companies in 53 countries globally, and 46 respondents in Kenya, covering a wide range of sectors. I would like to thank the respondents in Kenya for taking the time to participate in the survey.

We were also privileged to conduct in-depth interviews with Mr Adil Popat, Executive Chairman of the Simba Corporation; Dr Raju Mohindra, Founder and Chairman of the Dawa Group; Mr George Odo, Senior Partner and Managing Director, AfricInvest, East Africa; and Mr Mihir Shah, Head of Strategy, Sales and Marketing at Bidco Africa. I sincerely thank them for being so generous with their time and insights.

It is indeed an exciting time for family businesses in Kenya and globally. We are always pleased to have a conversation with you on any family business related topics, whether covered in this publication or not. Please contact me or any of the PwC practitioners who have shared their views in this report for more information.



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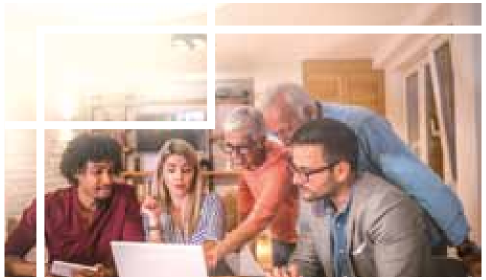

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Growth – and how to sustain it

The 2018 survey of family businesses reveals great confidence in the future, with over 80% of respondents in Kenya predicting steady or aggressive levels of growth over the next five years.

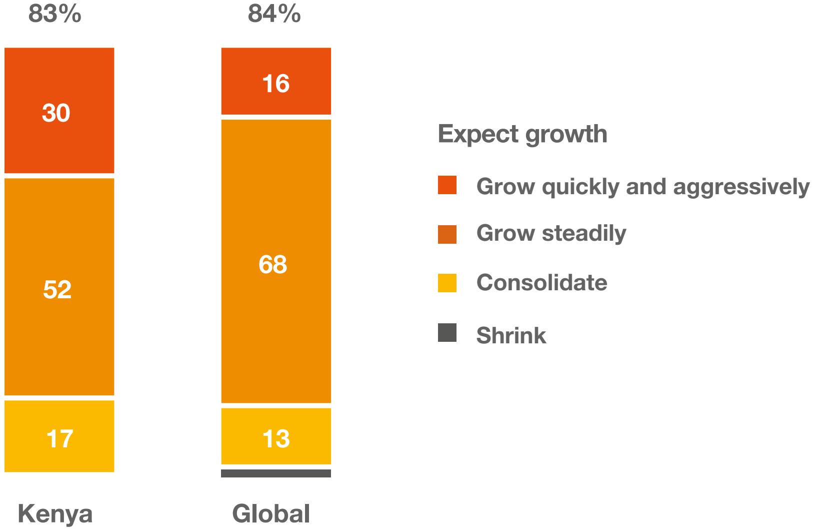
The 2018 survey results shows that family businesses in Kenya are in robust health, with revenues expected to continue growing for the vast majority (82%), compared to 84% globally, with 30% of Kenya respondents saying that growth will be 'quick' and 'aggressive' compared to 16% globally (see Exhibit 1).

74% of our Kenya respondents experienced revenue growth in the last 12 months before the survey was conducted, compared to 69% globally. This is a slight improvement from the 71% in Kenya and 64% globally who reported revenue growth over the same period when we last conducted the survey in 2016.

These findings echo what we found in the private company cut of our global 2018 CEO Survey, where a solid majority of private company chief executives said they were somewhat confident or very confident about their company's growth prospects in the next 12 months.

Of the 722 private company executives polled for that report, 85% said they were somewhat confident or very confident about their company's growth prospects in the next 12 months.

Exhibit 1: Growth aims over the next two years



In 2016, 84% of businesses in Kenya and 85% of Global businesses expected to grow over the next five years

Yet there is a nagging sense among many family businesses that the trajectory of growth over the next two years and beyond can't easily be charted, given a set of key challenges (see Exhibit 2).

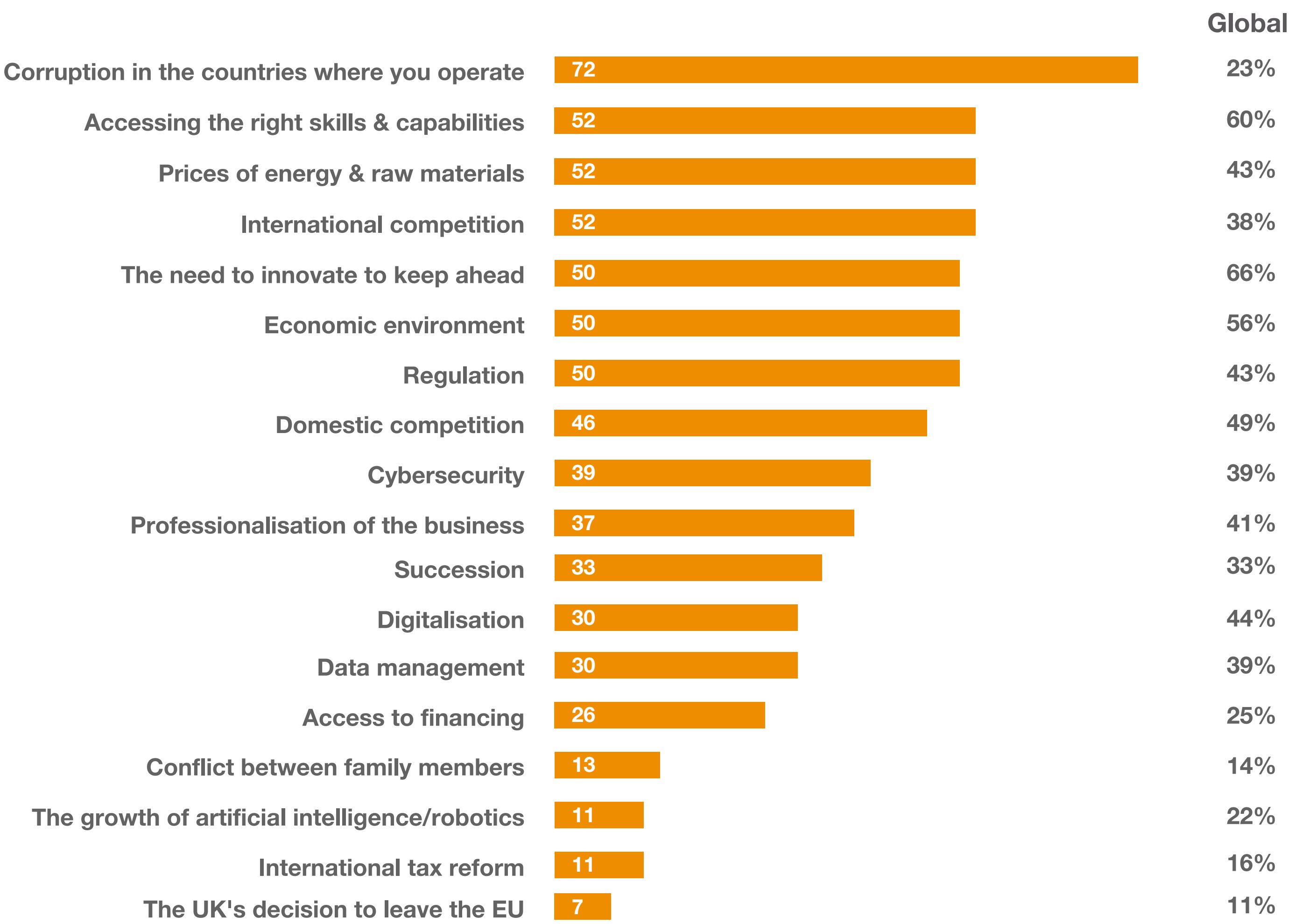
This is reflected in the steadily declining percentage of Kenya respondents who anticipate growth over the next five years: 88% in 2014; 84% in 2016 and 82% in 2018.

The top five challenges in Kenya were: corruption (72%), accessing the right skills and capabilities (52%), prices of energy and raw materials (52%), increasing international competition (52%) and the need to innovate to stay ahead (50%).

Both globally and in Kenya our survey respondents shared concerns about new market entrants and their potential to topple established businesses.

However, fewer businesses in Kenya (35%) feel vulnerable to digital disruption compared to the 2016 survey (40%) results. This result stands in contrast to our global survey, where 30% of global respondents feel vulnerable compared to 25% in 2016.

Exhibit 2: Key challenges over the next two years



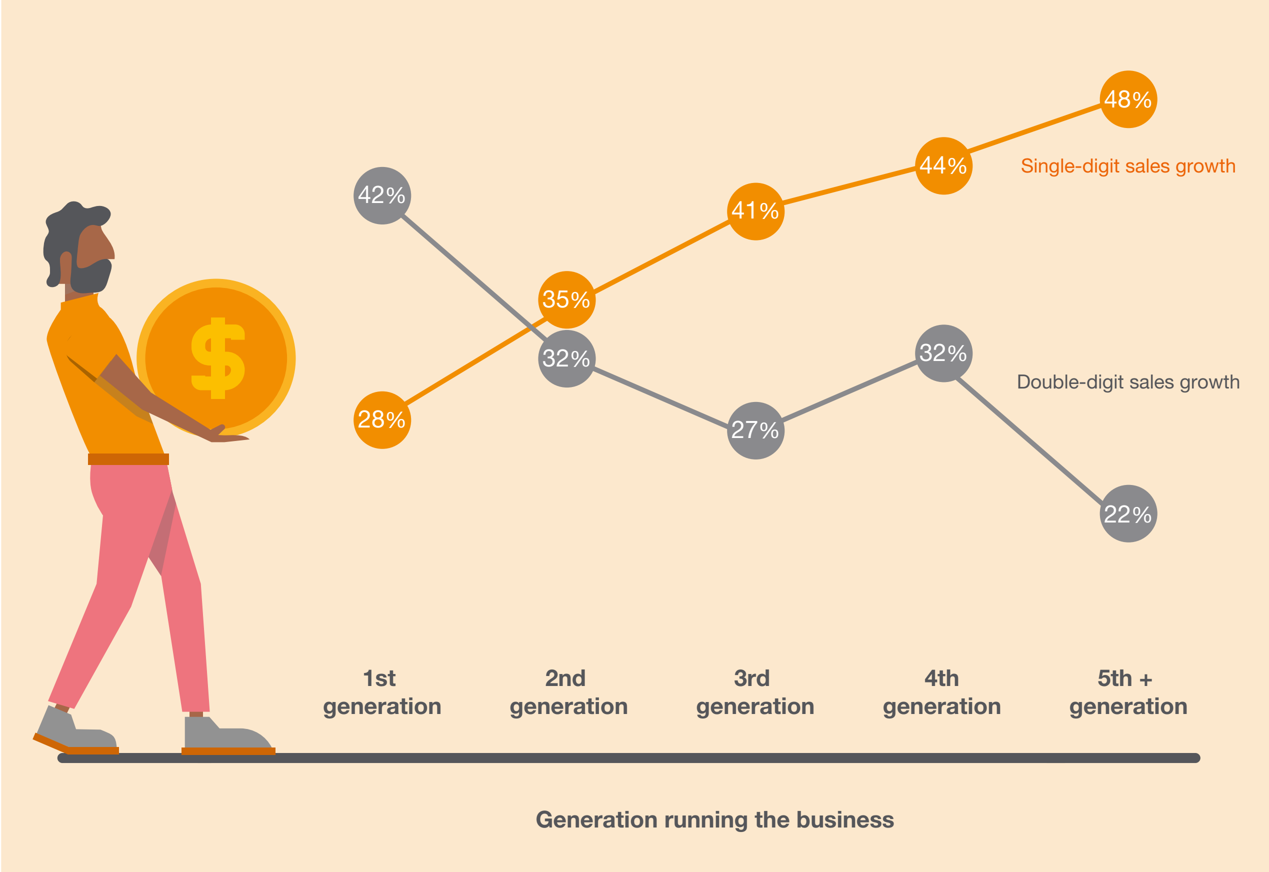
Our global survey findings show that first-generation family businesses clearly outperform those run by subsequent generations in their ability to achieve double digit growth, highlighting the need to balance business model continuity with an appetite for disruption (see Exhibit 3).

Reconciling optimism with concern for the future will naturally seem challenging. But one clear message that emerges from the Kenya respondents is that a values and purpose driven strategic plan is critical for a fast changing and challenging business environment.

Specifically, 87% of Kenya respondents said that they have a clear sense of agreed values and purpose as a business, compared to 79% globally.

And 48% had a fully-costed, formalised and documented strategic plan, similar to the 49% of global respondents who said the same. These findings tell us that it pays to take an active approach to values and purpose, and clear strategic planning.

Exhibit 3: Growth rate by generation running the business



Base: all 1/2/3/4/5+ generation global respondents (2018: all answering n=1,040/1,082/480/187/127)
Source: PwC Global Family Business Survey 2018

One of the main findings from our 2016 survey in Kenya and globally was that mid-term strategic planning (over a three- to five-year time frame) is often one of the biggest missing pieces of the puzzle for family businesses *(https://www.pwc.com/ke/en/publications/family-business-survey.html).*

This year, we found that survey respondents fall into three groups:

- The first group, making up 11% (21% global) of the total respondents in Kenya, has no strategic plan at all. These ‘low strategic planners’ seem to be more focused on keeping the boat afloat than thinking about where it’s going.
- The second group,making up 41% (30% global) of the total respondents in Kenya have a plan in mind, but it is not far advanced; it isn’t explicit about costs or methods for achieving the business’ goals. Together, these first two groups represent a little more than half of the companies surveyed, and, as a whole, they are more likely to fall behind over time.
- The third group, the remaining 48% (49% global) of respondents in Kenya, are those with a costed, formalised and documented mid-term strategic plan.

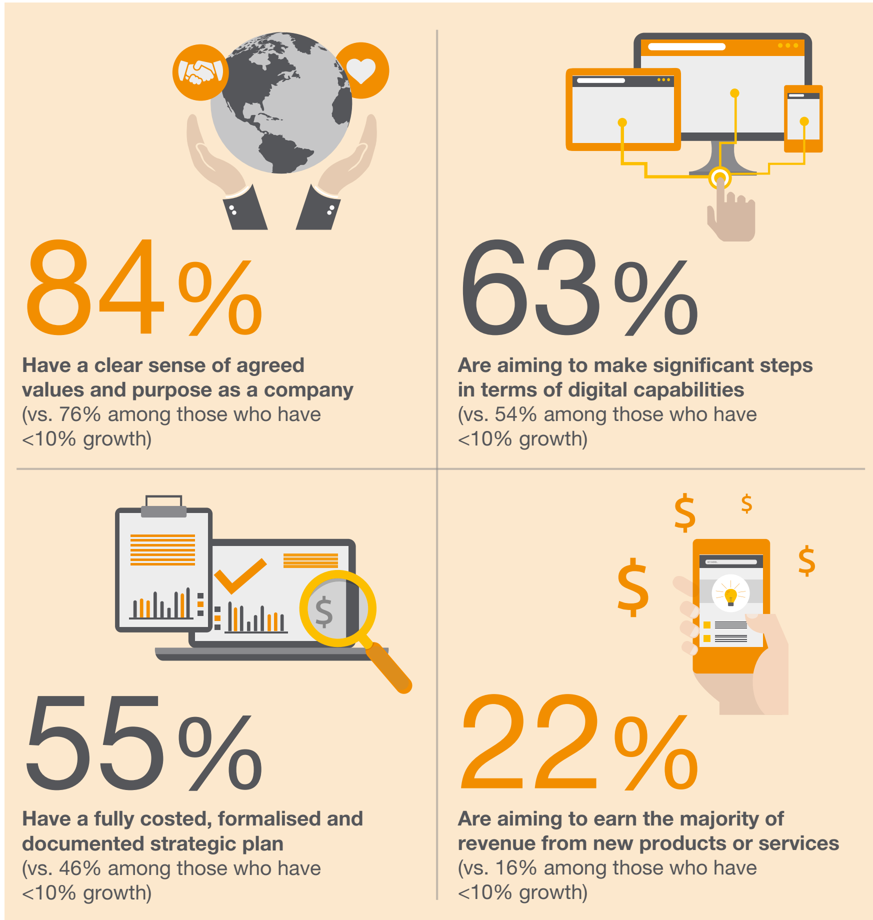
Among those Kenya respondents with any sort of strategic plan, 78% say the plan is embedded in their financial planning process and 56% say the plan has defined financial and non-financial key performance indicators (KPIs) in place to measure the progress and success of the plan. In both cases, the percentages of global respondents who say the same is higher (83% and 65% respectively).

Furthermore, 73% of Kenya respondents with a strategic plan have communicated the plan internally (compared to 83% globally) and 63% externally (53% globally).

The survey shows that in Kenya, there is a clear need to develop formalised and documented mid-term strategic plans, to embed them in the financial planning process and to define financial and non-financial KPIs to measure progress. Communicating these plans internally is certainly a priority, whereas external communication may be on a need-to-know basis (such as with potential partners with a financial interest).

Both globally and in Kenya, high-strategic planners are translating their strategic goals into everyday practices and building up the habits that, over time, create a distinctive legacy.

Exhibit 4: Behaviours of family businesses with 10%+ growth



Base: all global respondents with 10%+/<10% growth (2018: all answering n=1,000/1,001)
Source: PwC Global Family Business Survey 2018

Managing growth and the professionalisation journey

Dr Raju Mohindra, Founder and Chairman Dawa Group

Twenty-five years ago, Dr Raju Mohindra, his wife Reema and his friend Dr Ajay Patel founded Medisel (Kenya) Limited as a wholesale distributor of generic medicine. Their mission was to create an enterprise that would avail high quality medicine to Kenyans.

Medisel started off as a marketing and distribution company selling drugs sourced from India and China. In 2004, they acquired Dawa Limited, a rundown pharmaceuticals manufacturing plant under receivership, which they later upgraded to begin manufacturing drugs for local and regional consumption.

Dawa Limited has over the years become a successful pharmaceutical manufacturing company and is the flagship of the Dawa Group. The Group acquired a chemicals business, KEL Chemicals Limited, three years ago to complement the Group's established real estate and pharmaceuticals divisions. Dawa Group's commercial and real estate investments are in Thika and Nairobi.

Dr Mohindra, Reema and Dr Patel are close business partners who set the stage for a cohesive and robust business that now employs over 500 people across Africa. Dr Mohindra trained as a radiologist and is the current chairman of the group while Reema, his wife, is a management consultant and the Chief Finance Officer. Dr Patel, a professional pharmacist, is the group's operations director.

"Dawa Group has been growing steadily since its humble beginnings in 1994," said Dr Mohindra.

Expanding the business

Dr Mohindra is bullish on the future outlook of the business and the opportunities in the East African region. With a strong footprint in East Africa and Francophone West Africa, plans are underway to expand to Ethiopia, Angola and Mozambique.

"Pharmacy is an exact science and cannot be compared to the fast moving consumer goods sector, and therefore access to markets has to be specialised and optimal at all stages of the supply chain. The inspections at the borders are punitive," he adds. Recent investment of over US$40 million in professionalising the business and upgrading the operations across various functions are expected to transform the Group and facilitate their expansion plans.

On the Government's role to support the pharmaceutical sector, Dr Mohindra notes that more could be done by the regulatory bodies. “There needs to be increased restriction on imports for some drugs so as to promote local manufacturers. For instance, Ghana and other West African countries have restricted imports of some common drugs which has boosted the local pharmaceutical manufacturing sector,” he explains.

He lauds the inspections by bodies like the United Nations Industrial Development Organisation (UNIDO) to clamp down on substandard drugs, emphasising that quality is key to their sector and society in general.

Customer preferences and the regulatory environment

Market dynamics have changed over time for the group’s “typical” customer. The middle class has grown and it is apparent that lifestyle choices are very different as compared to 20 years ago. Drugs that sold readily 20 years ago included broad spectrum drugs like basic antibiotics. With today’s fast-paced lifestyle, poor food choices, and reduced outdoor activities for most people, lifestyle diseases have slowly crept up in prevalence. Consequently, the demand for the drugs to treat lifestyle diseases has risen.

The Group has had to develop a different product mix and over the years introduced an array of more advanced locally manufactured and imported drugs to meet new and evolving demand.

Professionalisation

The Group has embarked on the professionalisation of the business, driven by the implementation of robust information technology management systems primarily to streamline supply chain processes and steadily automate manufacturing operations.

Dr Mohindra also acknowledges that the transformation of the group requires the diversification of the senior management and extending business governance beyond family members. The recent recruitment of a non-family member as a managing director of the group has helped to diversify the senior management team. The board has also recently been restructured to bring onboard non-executive directors from different sectors to support management in creating efficiencies and streamline the business across the key divisions.

Even so, Dr Mohindra believes that the Group still needs to focus more on increasing local talent within the management team. Competent non-family members can be helpful on the journey of transforming family owned businesses into well managed and governed corporates.

As head of strategy, Dr Mohindra acknowledges the struggle in balancing good people and the cost of hiring them, although he does not hesitate to pay a premium for what he calls the “skills of the future”. “I am always open to growth, which is the spirit of entrepreneurship,” he says.

Technology and competition

“Dawa is still dealing with competition by innovating digitally. The influx of imports from markets like China and India require thinking innovatively about our Business 2 Business (B2B) model and just like online retailing, our traditional models in the pharmaceutical sector will be disrupted,” says Dr Mohindra.

Even as a traditional B2B operation, Dr Mohindra is open to Dawa Group acquiring an online digital partner to push online sales of a B2C nature. “A model similar to MyDawa, launched recently in Kenya as the first retail licensee for e-retailing medicine, is what we want. It would address speed and convenience for our customers,” he explains.

The future

Although the pharmaceuticals business provides a lot of opportunity and could be passed on to Dr Mohindra’s children, they have each chosen other careers. In hindsight, he says he made a wise decision by involving outside talent in management and on the Board.

Looking ahead, Dr Mohindra’s vision for the business is to “run it to prosperity”. Private equity firms and other investors have approached Dawa Group but Dr Mohindra indicates that they are not ready to relinquish control of the business. He is especially keen to transform the business digitally before considering outside investment.

Lastly, Dr Mohindra believes that what has worked for him over the years was his emotional detachment from the business. He and the other founders have been focused on handing over a sound business to capable professionals. As this handover takes effect, Dr Mohindra looks forward to spending more time with his family.

Getting value from your values

As decision making grows more complex during an accelerated pace of change, family businesses need to implement guidelines and tools to codify their values as a way to make better decisions. Based on our survey results and experience in the Kenya market, family businesses that make their values and purpose explicit and measurable, and incorporate them into their strategic plans, see better returns and greater longevity. Adopting an active stance towards values really pays off.

The values of a company are the operating beliefs and principles that guide behaviour among not just the leadership, but also its employees. These concepts often manifest in the company's culture.

They affect not just what a company says but also what it does. For example, a family business might collectively agree on the need to diversify its product offerings or expand into new markets, just as it also might agree on the need for greater trust and cohesion among family members and employees. Genuinely held values become ingrained in everyday practice: the deals made, suppliers worked with, products and services launched and ways of managing employees.

Companies that are managed with strong values, a clear purpose and an eye for legacy will tend to build trust and loyalty among staff, suppliers and consumers, and will have greater resilience during downturns. This is why family businesses are often viewed as more trustworthy than other companies.

Although many family businesses are strongly aligned around a shared sense of values, they don't always use them to their full advantage.

What if family businesses codified their values right from the start and made them active? Our research shows family businesses that make their values and purpose explicit and measurable, and incorporate them into strategic plans, see better returns and greater longevity. Indeed, many of today's entrepreneurs are founding companies based on a clear set of values, and many of them have themselves come from family-led businesses, where they would have learned, first-hand, the role that clearly articulated values can have. Businesses that talk about their values as 'social capital' and treat this as an asset that is relevant to today's world can get better returns if they act smartly and communicate their values effectively.

Businesses that embody their values in everyday practices and routines get better results. "The ones that get it right start with understanding the value of values. They get that this is what distinguishes them in the market. It's their DNA, their secret sauce," says Dr. Justin Craig, a professor of family enterprise at Northwestern University's Kellogg School of Management. "This is what has helped them across previous disruptions. The thing that distinguishes successful family businesses is that they take the time to communicate and educate and remind themselves, and the next generation, early and often about the value of values."

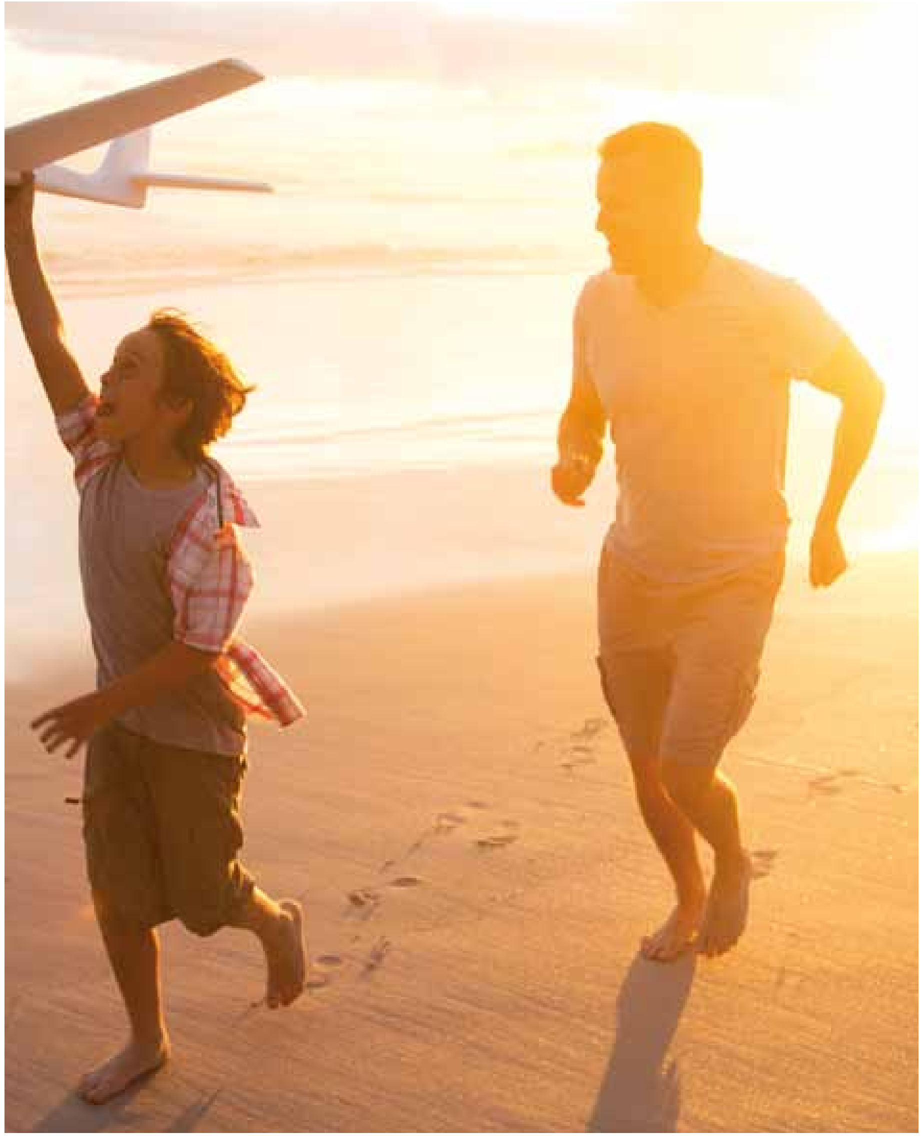
In this year's Family Business survey, we set out to test some of our experiences about the importance of values. We found that 87% of Kenya respondents felt that they had a clear sense of values and purpose as a company, compared to 79% globally. Of the total, 73% felt strongly that having a clear sense of agreed-upon values increased revenues and profitability (compared to 70% globally). Critically, a total of 73% felt that having a clear sense of values gave them a competitive advantage.

Other findings reinforce this point. In Kenya, a higher percentage of respondents reported growth over the last 12 months (74%) than global respondents (69%) and a higher percentage (87% in Kenya) have a clear sense of agreed values and purpose (79% globally). Values and purpose matter even more in markets like Kenya, where corruption is a significant challenge to doing business. Another challenge faced by 93% of respondents in Kenya, attracting and retaining the right talent, also speaks to the importance of strong values. Honest, hard working people want to work for others who share those values.

Our survey showed that 68% of Kenya respondents that had a clear sense of values felt that this helped attract potential joiners (compared to 79% globally) and 83% felt that their values and purpose made their company a happier place for employees to work (compared to 85% globally). A total of 80% in Kenya and 82% globally felt that their values and purpose had improved their company's staff retention.

As decision making grows more complex, particularly in an accelerated stage of change, family businesses need more than ever to implement guidelines and tools to codify their values as a way to make better decisions. Indeed, living up to codified values and purpose is the most effective risk management system.

When it comes to codifying values, a good starting principle is to keep it simple. With just over half (54%) of Kenya respondents reporting that they have documented their values, one of the challenges could be the documentation process itself.



“The Aspire value is not only a corporate identity but is encouraged as a personal mantra of self-belief translated to day to day work at Simba.”

- Adil Popat, Executive Chairman, Simba Corporation

No matter how solid your values are, they will change over time. As the business grows and new people join in, leaders need to revisit what those values are and, in some cases, refresh them. Values cannot simply be assumed; they need to be brought to life by living up to them. So, it is important to talk about values regularly to make sure people agree on what they mean and their relevance. It is also crucial to examine whether values drive the right behaviours to improve performance, including those of management, staff and stakeholders. Everyone must be committed to the actions needed to support these shared values.

“We are celebrating 60 years of business this year. This year is dedicated to our elders and our founders who had the guts to start the business.

Family values are based on discipline and ensuring that we portray to the community at large that this is a company that works well, works hard and looks after its employees in total.”

- 3rd generation Family Business owner, Kenya

It is also useful to recognise the difference between having family values and having values that work for the business. Values need to be creatively shared and reinforced in family businesses involving more than one generation.

Values are more effective when explicitly communicated to customers and suppliers, as exemplified in South Africa by the approach taken by ZZ2, the country’s largest independent agriculture group, which traces its roots to the owning family’s farming activities in 1698. Chief Executive Tommie van Zyl says everyone from the purchasing office through to the logistics supply chain understands the business’s value system. “We adopted an ‘open systems philosophy’ in our business. Instead of focusing internally on the family or on the business all the time, the focus should be outside of that, and thinking about the interactions and the linkages in the wider world,” he says.

Values should be communicated explicitly and clearly if they are to be adopted across the family business and beyond.

Stewardship and the values that inspire

Adil Popat, Executive Chairman

Simba Corporation

"Our engine is our people," says Adil Popat, Executive Chairman, Simba Corporation. "I have been blessed to work with good Kenyans and build a stable and sustainable business."

The early years

Simba Corporation was founded in 1948 as a used car dealership on Koinange Street in Nairobi's Central Business District by the late Abdul Karim Popat. "My father was a hardworking and disciplined man," reminisces Adil Popat, Abdul Karim's son and a second generation business owner. "He worked long hours and regularly took the train 300 kilometers away to Eldoret, a town in the northern part of Kenya, to buy used vehicles for resale. He would diligently travel, write multiple books of accounts for his clients, while making time to attend the mosque every day."

From those humble beginnings, Simba Corporation now has an annual turnover of over US$ 100 million and employs about 1300 people. It operates in the motor vehicle, hospitality, fleet management, car rental, real estate, financial services and power systems sectors.

Planning and management

Since 2007, Simba Corporation has experienced great change and diversification. The group grew its auto dealership portfolio with the introduction of BMW, Mahindra and Renault franchises as well as a separate division, Africa Fleet Management. The group also ventured into hospitality with the building of the Olare Mara Kempinski Camp, the Villa Rosa Kempinski and Simba's own branded hotel, the Acacia Premier in Kisumu. This propelled Simba wholeheartedly into the Kenyan hospitality sector.

Regarding expansion, Adil remains cautious. The group is on the look-out for new opportunities in the region, but the management team keeps a clear eye on risks as well as the expected benefits. "We prefer creating partnerships with strategic investors when the time comes along and according to Simba's four pillars: motor vehicles, hospitality, real estate and financial services," he says.

"Change is inevitable," Adil continues. "Especially for the motor vehicle franchises." He took over when turnover was modest and operations still small. These have grown steadily over time amidst fierce competition from other brands.

NextGens in the family business

Adil has exposed his children to the financial, legal and strategic aspects of the business in recognition of the important role they play in influencing the group's future. Adil is keen to reinforce that talent in the group is supported and hard work appreciated and rewarded. However, the next generation should not be forced to join a family business but should earn their place in the business based on their skills and interest.

He says that the family constitution is clear about the involvement of spouses and the wider family in the business. Where gaps would be cited in running the business, it is also clear at what point consultants would need to be engaged.

"I would want my family working together and living harmoniously, and find prestige in working for the family business," he adds. He is realistic, however, and mentions that there are mechanisms in place for exit if family members so wished.

Values and Legacy

Adil reinforces that the ethos and spirit of Simba Corporation is underpinned by its core value: Aspire. The Aspire value should resonate with all those that lead, work for, partner with, and do business with the group. Adil encourages the team to articulate their personal aspirations and to provide input into the group's aspirations as well. He believes that alignment of the company values with people values is fundamental for greater success.

Integrity is also a key pillar for the group. They strive for transparency and honesty in running the business and Adil says that he is not averse to "growing the group slowly and steadily" for the sake of doing the right thing.

Finally, Adil recalls how he and his late father related to each other. He says that they had candid conversations about whether it was necessary to keep expanding yet they were already so successful.

He remembers responding and envisaging a legacy that transcends the current generation, of building a business that was viable well into the future, and one which contributes good to the society. "I am keen that the Simba name resonates with good work and projects that are visible in the marketplace," he concludes.

Alignment of the company's values with its peoples' values is fundamental for greater success.

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Family values and tax compliance

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Values have emerged as a front-runner issue in this year's Family Business Survey report, and rightly so since values are indispensable when it comes to sustainable commercial growth and success.

One area where values contribute immensely is the area of regulatory and tax compliance. Values enable a business to prioritize tax and regulatory compliance by reinforcing messages about doing what is right.

Strong values are usually reflected in company policies which express zero tolerance to deliberate non-compliance and whose disciplinary procedures reflect how seriously a breach is to be treated. Furthermore, it is not unusual to see whistleblower portals in larger companies that enable anonymous reporting of policy infringements.

This is because good business ethics are no longer optional - the reputational damage which accompanies non-compliance erodes the bottom line swiftly and sometimes even conclusively. In this era of instant news and social media, a whiff of accusation will set the Twitterverse ablaze before you've had your morning coffee!

When it comes to taxation, the values that tend to dominate the conversation are around openness and transparency. It is not enough to report the least possible information that one can get away with - complete and accurate declarations are required, especially around foreign transactions and relationships.

Providing comprehensive data to the tax authority can feel daunting because taxpayers may fear that the information will be turned into a weapon and used against them. For example, disclosures around foreign affiliates may result in additional foreign income being incorrectly assessed to tax or a fuller disclosure in one year of income may lead to questions being asked about prior years where the information was scantier.

To these concerns, we make several responses. First, the Kenya Revenue Authority (KRA) is consciously pursuing a more facilitative approach

with its customers. This is part of a global move by tax administrations worldwide to work together with taxpayers to achieve co-operative compliance through trust and engagement. Admittedly, there is still some way to go but the initial signs are encouraging.

Second, if a taxpayer does not want to open a Pandora's Box by declaring foreign income or foreign affiliates that have not been previously declared, then there is an ongoing Tax Amnesty that may offer a solution. A successful amnesty applicant will enjoy immunity from investigation into past actions that continue to haunt them (related to tax on foreign income or assets). It is a chance to wipe the slate clean and start on a fresh note.

Third, as tax authorities enter into more treaties for exchange of information and as they eventually implement the Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standards (CRS) provisions, details of our foreign income and assets will become more visible. We also anticipate greater collaboration between different government agencies and institutions which will result in the taxman having access to even more data.

Against this backdrop, it is advisable for taxpayers in the family business sector to consider how best to remediate any prior year exposure. The process needs to be handled with care and this is one area where in-house teams can benefit from the support of external professionals whose ethical values mirror their own. Beyond sorting out the past, family business may need to invest significantly in tax technology and higher quality tax services to improve compliance in future. This is especially true for companies that are becoming increasingly complex due to organic growth, acquisitions and greater cross border activity.

Values need to be visibly represented by behavioral change and we applaud the family businesses that are determined to build a culture of enhanced compliance and openness. This shows that they're ready to play in the major leagues where consistent and penetrating scrutiny by regulators and stakeholders is unavoidable.

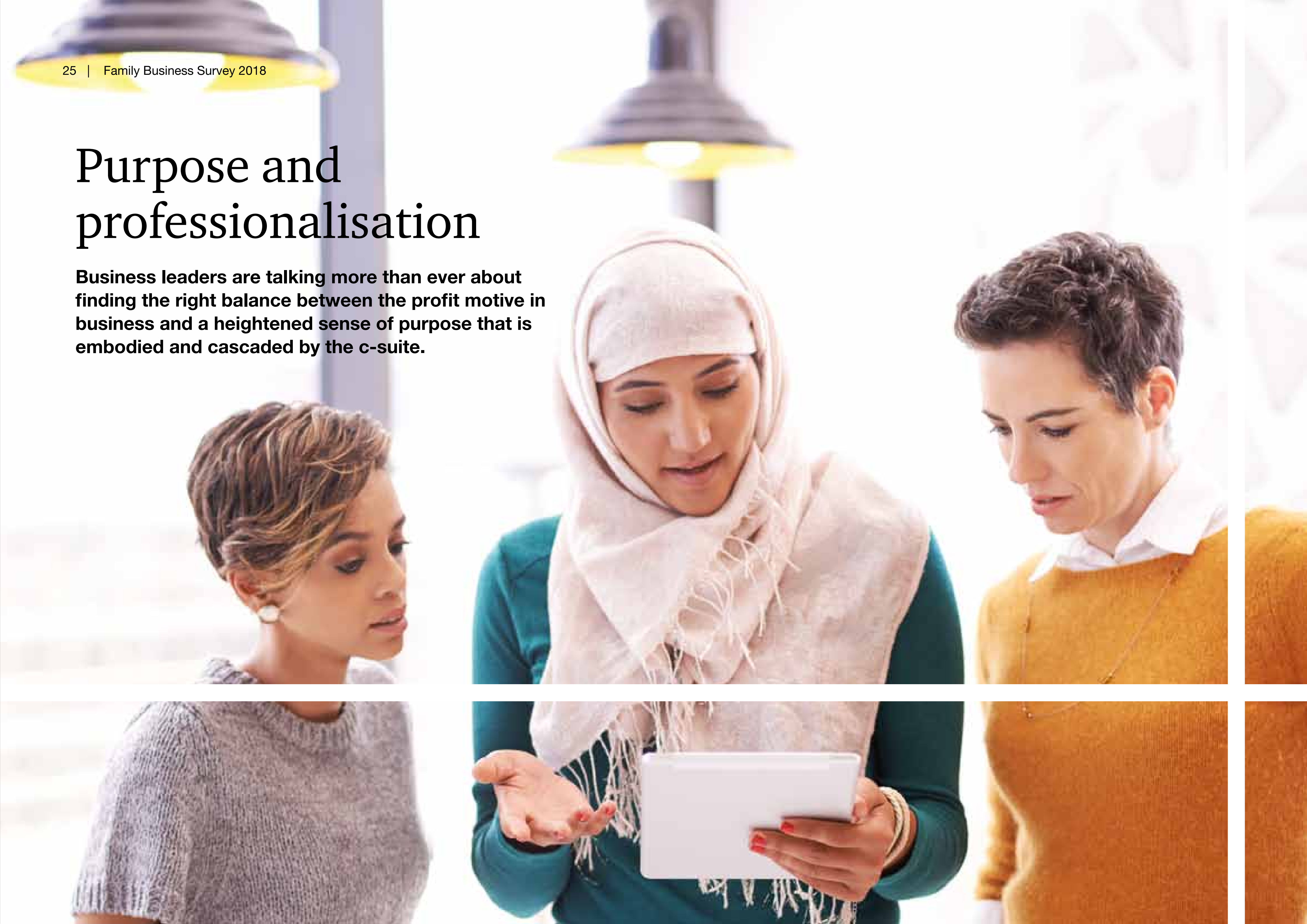
Five principles for getting value from your values

Peter Englisch,
Global and EMEA Family Business Leader, PwC Germany

1. Be specific about your values: codify them, write them down and act on them. Do this with the full involvement of family members. This will strengthen not only your family cohesion but also help you to make better decisions for the family business.
2. Communicate your values internally and externally to activate your family business advantage. Many family businesses have values but don’t always bring them to others’ attention. You can’t get value from your values if you don’t communicate them.
3. Develop business principles and a code of conduct that brings your values to life. This helps to build trust and credibility internally and externally and opens doors for new business partners.
4. Put values at the forefront of your recruitment efforts and embed them into your workplace, as you seek to bring the best talent to your business. Displaying your values is a good way to attract and retain the best talent for your business.
5. Focus on value creation along the entire value chain, such as ensuring that you work according to shared ethical standards. Your values have a mutually reinforcing impact beyond your own business.

Purpose and professionalisation

Business leaders are talking more than ever about finding the right balance between the profit motive in business and a heightened sense of purpose that is embodied and cascaded by the c-suite.



The purpose of an enterprise is its reason for existence: the expectations you have about what products and services you produce, why those create value and what you will do with the value you create in the world. Beyond making money, your purpose might include providing for your family and community, fostering an innovative way to improve the lives of your customers or realising an aspirational business goal. The family originally founded or acquired this business for a purpose, and unless that has changed, you are still here to realise it.

Today, business leaders are talking more than ever about finding the right balance between the profit motive in business and a heightened sense of purpose that runs through the c-suite.

Survey after survey shows that the millennial generation, which makes up the majority of the working-age population in Kenya, expects companies to contribute to society, have a clear purpose based on values and be more sustainable. They want to work for companies that they feel good about and tend to buy from those that meet their ethical standards. To be accountable in this way, businesses will increasingly need to track their activity and its impact, such as through Integrated Reporting.

In our survey, 74% of Kenya family businesses and 68% globally had a documented vision and purpose, or mission statement, for their company.

Purpose speaks directly to the professionalisation journey, which we have explored in our 2014 and 2016 Family Business Surveys in Kenya. In 2018, our survey shows that a larger percentage (66%) are involved in multiple sectors or multiple markets, or both, compared to 56% in 2016, whereas the global percentage change over the same period is negligible.

In the next two years, two-thirds (67%) of Kenya family businesses intend to make significant steps in their digital capabilities and 61% plan to bring in experienced professionals from outside the family to help run the business, both significant steps on the professionalisation journey for many family businesses.

Just over half of Kenya family businesses report having a succession plan in place in our 2018 survey, although just 17% report that it is robust, formalised and communicated. This is largely unchanged from our 2016 survey.

Expanding into new segments or markets, digitalisation, external recruitment of senior managers and succession planning are all hallmarks of the family business professionalisation journey. There are other indicators, but our 2018 survey shows that a common purpose can unite a family business, improving its performance as well as the professionalisation of its operations.

Five principles for pursuing purpose

Michael Mugasa,
Leader, Private Company Services
PwC Kenya

1. Purpose defines your ‘license to operate’ beyond making money. Be clear on which problems your business is committed to solve, and what kind of value you want to generate for your customers, employees, stakeholders and society.
2. Define the link between your products and services and the company’s purpose. For example, running a company that sells inputs for farmers means not just being great in sales and outreach terms. It is also about a broader purpose that has to do with feeding populations and helping farmers achieve this efficiently.
3. Focus on real and sustainable value creation according to your defined purpose along the entire value chain. Consider the impact on your business model and leave room for necessary adjustments.
4. Apply and monitor Corporate Social Responsibility (CSR) principles and define key non-financial performance indicators that support you better in long-term decision making to achieve your goals and support your family business brand.
5. Communicate your defined purpose internally and externally, as well as what you’re doing to achieve it. This will help you align and unify various stakeholders, strengthen your employer branding and bring your competitive family business advantage to life.

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The new revenue standard ‘IFRS 15’ – Is your business compliant?

Akinyemi Awodumila, Associate Director,
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PwC Kenya

Every entity reports revenue and consequently every entity will be impacted by the new revenue standard IFRS 15. The degree of impact will vary from one entity to another. Therefore, businesses should conduct an impact study to understand the implications of the new standard on their business.

Revenue remains a major measure through which the viability of any commercial venture is assessed. The old revenue standard IAS 18, developed in 1982 when the business landscape was basic and straightforward, had become obsolete.

The rapid changes in the business environment, operating models, commercial arrangements and globalisation led to the need for a new standard as the old standard had limited guidance on these issues, resulting in different industries developing different practices and rules to deal with the shortcomings of the old standard. This pushed the International Accounting Standards Board to develop IFRS 15, with a set of principles, which when applied, ensures entities irrespective of their industry recognise revenue using the same basis.

IFRS 15 is effective for entities with annual periods beginning on or after 1 January 2018. The standard applies a 5-step approach for revenue accounting. These steps, though simple, could lead to significant changes in the timing, amount and pattern of revenue recognition for businesses when compared to the old revenue standard. The five steps are:

1. Identify the contract with the customer;
2. Identify the performance obligations;
3. Determine the transaction price;
4. Allocate the transaction price to the performance obligations and
5. Recognise revenue as the performance obligations are satisfied.

For instance in step 1, there is a lot more emphasis and guidance on the assessment of a customer’s credit risks to determine whether a revenue contract exists or not.

Family businesses might need to update systems, processes, controls and policies impacted by IFRS 15 accounting changes.

This could impact entities dealing with a wide variety of customers that are unable to assess customer credit risk at origination of revenue transactions. Some of the industries affected include utilities, real estate and government related agencies.

Step 2 requires entities to identify all performance obligations or promises made to customers in a contract from the perspective of the customer. This could lead to identifying more promises than had originally been identified.

Entities have had to account for free goods and services including material rights offered to customers which has changed the pattern of revenue recognition. Industries affected include brokerage businesses, agency relationships, telecommunication, technology and membership/joining fees/activation fees.

Determining the transaction price in step 3 introduces concepts such as time value of money, consideration for revenue received either later or in advance, which results in consideration received from a customer to be split between revenue and interest income or interest expense. There is now a concept of variable consideration that could change the amount of revenue an entity can recognise when there is variability in a revenue contract.

An entity is required under step 4 to allocate that transaction price to every promise identified in step 2. This allocation now needs to be done using the stand alone selling price for each promise (to the extent those promises are sold separately in the market) in the contract. This has affected the performance reporting for many entities at a product level and their revenue recognition pattern.

Step 5 brings to the forefront one of the main highlights in the new standard. The former standard, IAS 18, relied mainly on a concept of risk and rewards, which meant entities recognise revenue as risks and rewards from goods and services are transferred to customers. IFRS 15 on the other hand is hinged on a concept of control, which means revenue is recognised on transfer of control on goods and services to a customer. This could lead to significant changes for entities regarding the timing of revenue recognition.

Also within step 5 is the ability for entities to recognise revenue for goods and services with no alternative use and for which an entity has a right to payment for work done to date, over time as opposed to when the project is completed at a point in time. This could affect customised manufacturing and long term contracts.

Where an entity is a principal, the entity reflects the gross revenue and any payments to agents as an expense, however an agent only reflects the commission earned (the net revenue). Changes to this guidance means entities need to reassess previous analysis using IFRS 15 to confirm whether entities still meet the requirements to be principal or agent. This could affect entities such as dealerships and agency arrangements.

Contract acquisition costs guidance, requires costs incurred (incremental) to acquire contracts to be capitalised and spread over the life of the contract if an entity expects to recover those costs. This could affect entities paying commissions and brokerage fees for contracts acquired.

It is important that entities plan for the tax effect of any changes on transition. In addition, changes to the timing of revenue recognition needs to be effected with the tax authority in mind, because the tax man might have different timing/trigger for the collection of tax balances such as VAT on invoice.

Family businesses might need to update systems, processes, controls and policies impacted by IFRS 15 accounting changes.

Securing your legacy in a digital age

Although family businesses recognise the challenge of digital technology, that doesn't mean that they are ready for it. One place to start is the board, where a strong combination of directors with the right skills can be hugely beneficial as family businesses look to tackle digitalisation. Another focus can be on millennials, who are the best-educated generation in history and are extremely tech-savvy. Part of a family business' legacy will be determined by the way in which the next generation is encouraged to be involved.

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Thriving in the face of digital disruption

Alex Muriuki, Associate Director, Technology Services
PwC Kenya

Family businesses globally are facing significant disruption from emerging digital technologies such as Artificial Intelligence (AI), the Internet of Things, 3D printing, Augmented Reality, Virtual Reality, Blockchain and Robotics.

According to our survey 35% of family businesses in Kenya feel vulnerable to digital disruption which is higher than the global average of 30%. As an example, a new manufacturing entity could establish presence in the market and introduce a highly automated manufacturing process using robotics and 3D printing and with the ability to tailor consumer products to specific customer preferences and at lower cost. This would make incumbents struggle to compete and result in an "Uber" effect. For those in financial services, the traditional brick and mortar model is rapidly being disrupted by digital channels.

While the threat of disruption is real, family businesses should also look at these trends positively and focus on the opportunities provided by these technologies to support innovation of their businesses, increase efficiency and provide better experiences for customers. To name a few examples, companies are deploying chatbots to provide a more responsive customer service experience. Others are adopting robotics process automation to automate manual repetitive and rule based tasks to increase productivity, lower costs and reduce human errors among other benefits. Yet others see AI as providing an opportunity to better predict their customers' specific needs.

From our survey, 67% of family businesses in Kenya plan significant steps in building digital capabilities in the next two years. Those that manage to integrate the disruptive technologies into their business strategies and to successfully implement them are set to gain significant benefits.

Kenya has characteristics that make it ripe for digital innovation. Kenya has a young population with almost 75% of the population estimated to be under the age of 30. This is a generation that has grown to expect instant services such as shopping and banking online and continually expect the same level of service across industries.

A young technology savvy population also provides a pool of talent that can help family businesses reinvigorate their internal capacity and attain a more innovative culture. For family businesses, the first point of call to inspire innovation may be the next generation of family members. In our survey, 61% indicated that the next generation was already part of the business.

In our experience, there are a number of critical success factors to successful digital transformation. An important starting point is having a clear digital strategy that is regularly updated and that is part of the organisation's overall business strategy. Not all emerging technologies will be relevant to your business. A digital strategy helps to define how an organisation can leverage specific digital technologies that have the most impact on achievement of the organisation's strategic goals. It is critical to define this strategy so as to ensure that the organisation's resources are utilised in areas that have a clear business case and where they can make the most impact.

A digital strategy helps to define how an organisation can leverage specific digital technologies that have the most impact on achievement of the organisation's strategic goals.

The next step is to put in place capabilities required to successfully implement the digital strategy. Our experience globally tells us that although family businesses recognize the role of digital disruption, it does not mean that they are ready for it. Digital transformation needs to be driven from the top and it helps to have the right experience and sponsorship at Board level as well as within senior management.

The culture of the organisation needs to support innovation; the right tone from the top as well as finding the right talent can help. From our survey, family businesses globally and in Kenya cite the challenge of finding talent that is not only skilled in digital but also understands their businesses well enough to be able to navigate the unique demands of each industry.

The young technology savvy population in Kenya provides a useful pool of talent open to new digital ways of working while being mentored by more experienced employees that have a deep knowledge of the business. In our survey we found that 69% of respondents expected or encouraged the next generations they hire – including their family members – to gain experience outside the family business. They recognise that no company has a monopoly on digital innovation, and it's better to learn from a broad base of experience.

If not well planned, digital transformation projects can tend to be complex and high risk. It is therefore important to put in place the right governance structure and processes. Good governance will enable the organisation to define the right digital strategy, select the right technology partners, manage delivery risk and increase the likelihood of adoption.

As increasing digitisation becomes a reality, organisations will also face more exposure to cybersecurity threats. In our survey, 59% of family businesses surveyed in Kenya feel vulnerable to a cyber-attack. Mitigating cyber security risks should be part of the digital strategy and implementation process and not an afterthought. The right partner can help to mitigate risks and increase your chance of success on your business's digital transformation journey, and should understand your business.

Family business leaders are waking up to the disruptive reality of artificial intelligence (AI), the Internet of Things, digital fabrication (3D printing) and robotics.

Thirty five percent of our Kenya respondents said that they feel vulnerable to digital disruption, compared to 30% globally. In Kenya, this is significantly lower than the percentage that said so in 2016 (40%) whereas globally, the percentage is higher than in 2016 (24%). Two thirds of Kenya respondents (67%) are aiming to make significant steps in terms of digital capabilities in the next two years, compared to 57% of global respondents. These discrepancies between the Kenya and global respondents shows that Kenya's family businesses feel more vulnerable, overall, than their global counterparts but they are investing in digital capabilities — perhaps helping them to feel more confident about the changes ahead, as compared to the survey results in 2016.

Among the specific technological advances cited as challenges by the survey respondents in Kenya were cybersecurity (39%), digitisation (30%) and the growth of AI and robotics (11%).

Exhibit 6: Where family businesses see themselves in two years

"Dawa is still dealing with competition by innovating, digitally. The influx of imports from markets like China and India require thinking innovatively about our Business 2 Business (B2B) model and just like online retailing, our traditional models in the pharmaceutical sector will be disrupted."

- Dr Raju Mohindra,
Founder and Chairman, Dawa Group

Although family businesses are starting to recognise the challenge of digital technology, that doesn't mean that they are ready for it. Globally, the most likely respondents to say that they felt vulnerable to digital disruption were in retail (53%) and media and entertainment (65%). When asked specifically about digital disruption, only a minority could talk about specific technologies, and only 20% of respondents felt they would have significantly changed their models within two years.

In Singapore, one of the most digitally connected cities on earth, we recently conducted a separate survey of family businesses in conjunction with the financial services firm UBS Group and the Singapore Chinese Chamber of Commerce & Industry. Even there, readiness was less than ideal. Just over 34% of those surveyed said digitalisation was included in their firm's strategic plan but also volunteered that it had not been mapped out in a well-thought-out approach. One quarter of respondents said they were in the early stages of rolling out their digital strategy.

Some family business leaders recognise this gap and are expressing concern. Others keep coming back to the challenge of keeping up with digital disruption.

Digital technology is a critical priority when seeking potential employees. The ability to innovate and find the right people to keep the company competitive is a rising concern. Innovation and skills gaps were two of the biggest challenges mentioned, in Kenya and globally, while business leaders also mentioned hiring, keeping and rewarding employees as top priorities.

One place to start is the board, where a strong combination of directors with the right skills can be hugely beneficial as family businesses look to tackle digitalisation. Another focus can be on millennials, who are the best-educated generation in history and are extremely tech-savvy. They have a significant amount to offer family businesses grappling with issues such as digitalisation. They are global citizens and represent a rich source of solutions to the skills gap, given their experience and education. And there's an important point: a family business' legacy will be determined in part by the way in which the family encourages the next generation to be involved.

"There's a big generational divide between the older, grey-haired, silver foxes and the next generation coming in," says Paul Andrews, Founder and Managing Director of Family Business United, a UK-based resource centre for family businesses. "Once they get these younger people, it's important to empower and allow them to do their jobs. The family businesses that don't embrace change probably won't be here in 20 years' time because they haven't taken the steps to address these issues now. When they do, it may be too late."

Interestingly, in our survey, we found that 69% of respondents expected or encouraged the next generations they hire - including their family members - to gain experience outside the family business. They recognise that no company has a monopoly on digital innovation, and it's better to learn from a broad base of experience. In PwC's recent NextGen study *(Same passions, different paths, 2017),* we found that young family members are joining their family's enterprise and already making a difference in digital technology.

When families recognise the value of the next generation and empower them to take the initiative on digital technology, it can be transformative for the enterprise. Rikki Maizey, one of our survey respondents, is Chief Executive of Maizey Plastics, a large South African maker of industrial plastics.

He explains how he has employed his son in a new role: developing an online store for the company's current and prospective customers.

"My son Richard has been working in the organisation for close to 18 months, but you know, we're dealing with Gen Y here. We have to sit down and listen to the younger generation and understand what drives them and what makes them tick, and then see how we can use that in our business.

"So, that's why I've been very specific with him on developing the online store for us," Maizey says.

There is an important note of caution here. Anecdotally, we hear from leaders that getting their own kids to join the business can be difficult and require flexibility about what roles they might play. Next-generation family members as a group are better educated and have more choices than preceding generations. They demand more meaningful work and have higher expectations from employers. Luring home next-generation family members after educating them abroad and widening their horizons presents the same hiring challenge.

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How can family owned businesses retain talent?

Jane Kithela, Senior Manager, People and Organisation

PwC Kenya

According to the newly released 21st Annual PwC Global CEO Survey, international trends show heightened expectations of businesses by employees, society and the communities impacted directly by their operations. That's why every business needs a clear and well-articulated purpose – one that goes beyond financial goals to incorporate a broader set of shared values and behavioural expectations.

Purpose defines 'who' a business is and 'why' it exists while values and behaviours define its culture. Both purpose and values act as vital guideposts and benchmarks for important decisions. If a decision or initiative falls short in any respect, it can erode a vital commodity: trust. Why is trust important in family businesses? Because family businesses often seem "opaque" when it comes to the decision making apparatus and therefore their employees can grow to mistrust the owners. Employees who trust their supervisors (and their employers by extension) are more likely to stay with the organisation and to demonstrate higher levels of productivity.

While family businesses want to hire and retain top talent, few have put in place retention strategies to enable them retain their key talent. In this article, we discuss some of the strategies that are geared to improve talent retention.

First, it is crucial to have in place systems and processes that are transparently communicated and consistently applied. This means that from the entry stage of recruitment to the off boarding process upon separation from the organisation, the employee knows what is expected and what support and mechanisms are available to them.

The 'place' of the employee also needs to be clear – it can take the form of a role profile or job description together with a clear reporting line. In addition, the links and relationships to other colleagues or office bearers should be indicated in an up-to-date organisational structure. More importantly, opportunities for career advancement and growth need to be understood for employees to be happy.

A second strategy is to manage your reputation

"Our family values are developing a profitable business and making sure that all the staff, suppliers and customers are happy. Overall we want to be the best in the business, having the leading edge over the competition in how we provide service delivery.

Our values are honesty, being fair and sharing adequate rewards with people who have contributed to the success of the organisation."

- 2nd generation Family Business Owner, Kenya

by communicating your organisation's purpose, vision and values with investors, analysts, customers, suppliers, the media and other stakeholders. The values cannot just be theoretical, they need to be lived with concrete examples and success stories that can be publicised and celebrated. Such a winning culture will be highly dependent on how you treat your employees, whether your employees treat each other with respect and care and whether results are rewarded and unbecoming behavior is punished.

Third, family business owners can invest in developing a working environment where people want to stay. A conducive workplace has facilities that help employees to relax while being optimally productive. Workplaces are now evolving to become like second homes, with a variety of meal options, medical facilities on site, crèches for the young family, gym facilities, nursing rooms for returning mothers and an array of facilities to support people living with disabilities.

Whilst reward is not the most important factor contributing to staff retention, competitive staff

remuneration packages communicates how you value your staff. Equal pay should be granted for equal work so that cases of staff performing lower level jobs but earning a higher salary than their superiors does not arise.

Reward key and deserving employees with share based schemes and other incentive plans. This improves commitment and motivates them to behave like "owners of business". It also supports longer term retention, which is the key to effective succession planning.

Numerous studies have demonstrated that businesses with highly engaged employees experience higher customer satisfaction and lower staff turnover rates. They also outperform businesses with lower levels of employee engagement. This applies to family businesses as well hence the need to invest in and implement employee engagement and retention strategies. It is advisable to consult human resource professionals with the requisite expertise to craft a solution for your particular business and circumstances.

Challenging the old ways of doing business

Mihir Shah, Head of Strategy, Sales and Marketing
Bidco Africa

We spoke to Mihir Shah, a 3rd generation family member at Bidco Africa, about the role of NextGens in driving the success of family owned businesses.

Mihir started at Bidco four years ago after completion of his studies overseas. He had always wanted to join his family in running the business in Kenya and had ideas of starting new ventures and product lines. He says that working for the family business allows him the freedom to be creative and do more to enrich what is already going on. He is currently overseeing the strategy, innovation, sales and marketing departments at Bidco, focusing on Kenya and the export market.

New ideas

"Bidco has always been associated with edible oils," Mihir says, but from the start he was keen to innovate and introduce other products. His goal is to give customers more choice by diversifying the product mix into a wider array of beverages, foods and snacks. Attracting the right partnerships, such as Bidco's recent partnership with CO-RO, a Danish soft drinks manufacturer, is a step towards growing Bidco's Eastern Africa business.

That said, Mihir is careful to note how the stable business environment created by the first generation has contributed to the success of his ideas. That generation had installed a cohesive enterprise resource planning system, streamlined shared services and structured and resourced departments adequately, which paved the way for successful change.

Mihir believes that the customer is king and needs to be recognised and appreciated. The digital marketing efforts he has led through social media and other platforms have begun to make a difference in helping Bidco to connect more effectively with the target customer. Overall, he is cautiously optimistic because just like any other business in Kenya, the delayed electioneering period and liquidity constraints in the financial market have contributed to some uncertainty.

What matters?

Mihir is clear about where his departments need to be focusing and prioritises the customer's positive experience as a key outcome. In order to connect with the market, he believes in offering products that resonate with the customer through direct selling; fast distribution channels and simplified routes to market are therefore important. Many family owned businesses are agile in their decision making processes and he emphasises this as another advantage because customer complaints can be dealt with swiftly.

The people agenda is also important to Mihir's view of building a better business. He acknowledges some of the challenges related to finding the right local talent for certain positions as he continues to seek out young, ambitious and driven people to drive sales and marketing.

Bridging the gap with the founders

Mihir knew from an early age that the vision of the family business was ambitious: "To build an Africa business that was ranked first in market share among the fast moving consumer goods and services sector by 2030."

This vision was "big" but he was sure that it could be achieved by the future generations – like his.

Regarding owner and NextGen interactions, Mihir says, "Success can only be achieved through understanding across generations. Running a successful business means constant change and open channels of communication, although perhaps in a more informal way."

He is a strong advocate for issue-based discussions devoid of personalisation. NextGens require guidance, leeway and trust to generate and implement ideas freely and a chance to propose these to the older generation. "That is the spirit of disruption," he says.

Moving towards the vision

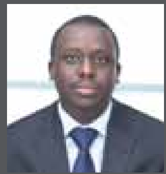
Among Bidco Africa's priorities is to constantly meet customers' needs by innovating and building the right partnerships. Mihir emphasises that every action he takes has to cause a ripple effect towards the achievement of Bidco's 2030 vision. There are checks and balances in place to ensure accountability at all levels and everyone stays true to the course.

Reflecting on his recent experience at the PwC's NextGen Leader Academy at Columbia Business School, Mihir expressed appreciation for the opportunity. "It was insightful and informative. I met likeminded NextGen business owners, many of whom were my age and ran their businesses with many siblings. It was refreshing to learn how they managed to keep each other happy, engaged and aligned to the founders' vision."

"NextGens require guidance, leeway and trust to generate and implement ideas freely and a chance to propose these to the older generation. "That is the spirit of disruption."

- Mihir Shah, Head of Strategy, Sales and Marketing, Bidco Africa

Five principles for building a digital legacy



Alex Muriuki,
Associate Director
PwC

1. Accept the reality that, thanks to the digital revolution, the world is different from the one you have experienced in the past as a family business founder and owner. You might have to rethink your assumptions about the way your business creates value.
2. Recognise that the next generation in your family business can play an important role in ensuring you are digitally fit-for-purpose — and so ensure your legacy in a rapidly changing world. Accept that you need help. What better way to get help than from the next-generation members of your own family?
3. Empower your next-generation family members, let them experiment and let them gain experience outside your business. Crucially, let them have the resources to do so. When they enter your business, agree with them on whether they have a custodial or 'intrapreneurial' role in a digital transformation — that is, whether they are merely stewards of the existing business or they will be given support and space to try a digital idea — some incubation capital, for example.
4. Enlist and encourage next generations to bring older employees along on the digital journey through 'reverse mentoring'. Reverse mentoring of parents counts, too!
5. Incubate the family's values and those of the business into the new digital business you are building. Don't assume that by adopting digital strategies you somehow need to change your family or business values; they usually remain as they were.

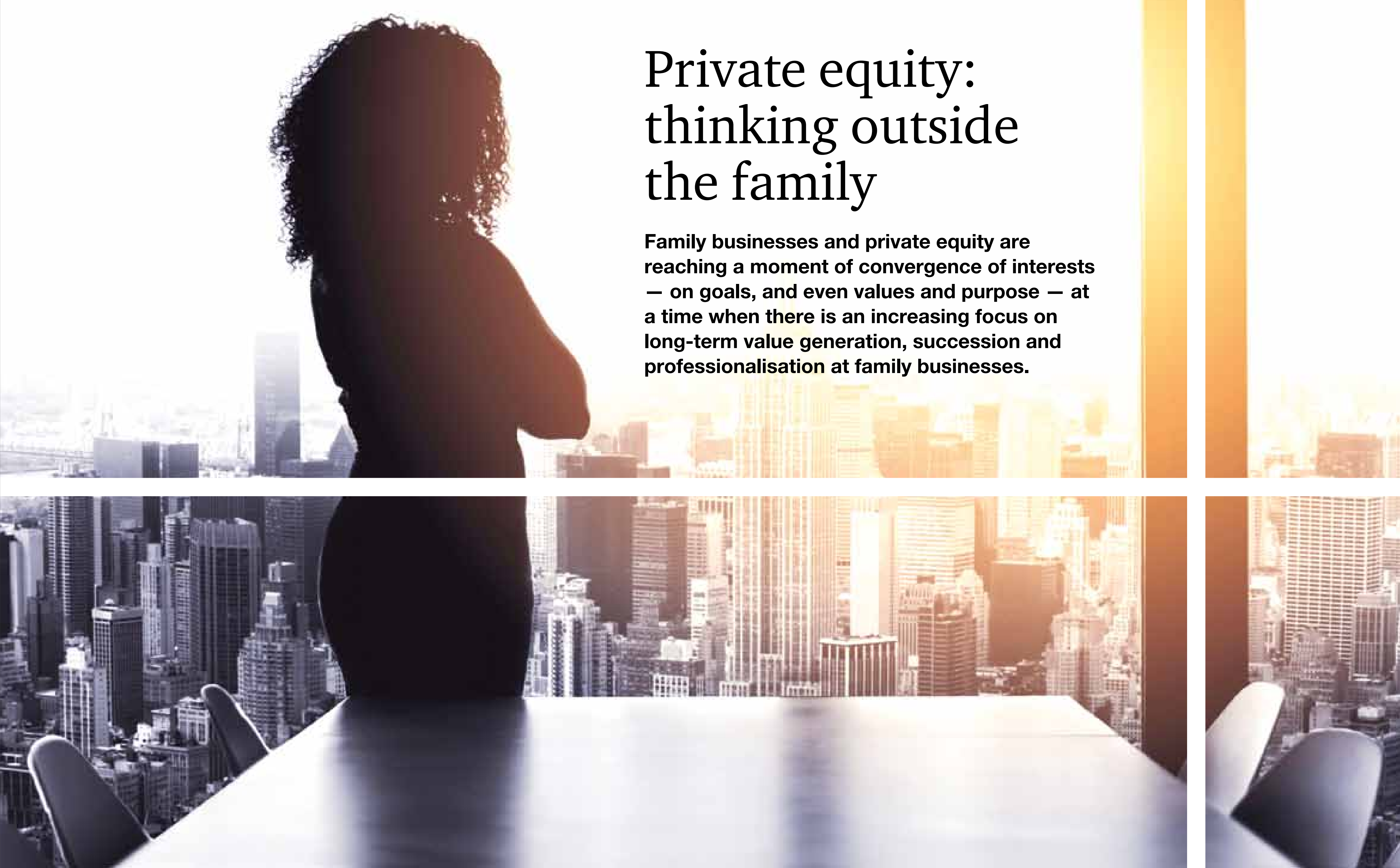
Five principles for a forward-looking legacy

Sunny Vikram,
Senior Manager
PwC

1. Thinking about the family business legacy — and how the family can and should continue it — can often boil down to simply thinking about succession. But there is much more to think about. Legacy should involve a plan for leadership succession, board succession and ownership succession, all combined. Pulling all of this together into a comprehensive, formalised 'continuity plan' really helps.
2. Build this up as your forward-looking, mid-term strategic plan for the business. Remember that it doesn't merely focus on how you transition to the next generation and how they become the new managers of the business.
3. It's important to emphasise that leadership succession is best handled through long-term strategy, not tactically at the time when the successor is needed. When planned over five to 15 years, the family can find a variety of candidates — family and non-family — and give them training and opportunities to grow.
4. Board members with multiple industry perspectives can prove helpful when navigating the vast amount of change that businesses are faced with today, especially those we highlight in this report around digital disruption.
5. A good ownership succession plan should look at the most effective ownership structure for the business and revisit it regularly to determine whether adjustments or improvements should be made. It is a continuous process and is not something done one time. It is something the leadership of a family should continually assess.

Private equity: thinking outside the family

Family businesses and private equity are reaching a moment of convergence of interests — on goals, and even values and purpose — at a time when there is an increasing focus on long-term value generation, succession and professionalisation at family businesses.



One of the most striking findings in our 2018 survey is that whilst 85% of Kenya respondents rely on internal resources and 83% on bank lending/ credit lines, 59% would consider private equity (considerably higher than the 39% of global respondents).

This tells us that family businesses and private equity are reaching a moment of convergence of interests — on goals, and even values and purpose — at a time when there is an increasing focus on long-term value generation, succession and professionalisation at family businesses.

Demographics and legacy are big factors. Globally over the coming decade, trillions of dollars will be passed down from one generation to the next in the largest transfer of wealth in history. As owners retire, family and private business leadership will change hands.

In this situation, family business leaders often face a choice between an outright sale, maximising growth potential before a sale, or ‘going for growth’ and engaging with private equity.

Perspectives of a private equity investor in family owned businesses

George Odo, Senior Partner and Managing Director

AfricInvest – East Africa

> "Private equity firms not only bring in capital but expertise that transforms businesses for the future. Fund managers add value to the businesses making them more attractive. We are not financial investors. Private equity is different."

- George Odo, Senior Partner and Managing Director, AfricInvest - East Africa

The journey so far

Private equity firms are playing a significant role in the transformation of family owned businesses in East Africa and globally. To get a view of the experience and practical challenges of external investors into family owned businesses, we interviewed George Odo, Senior Partner and Managing Director of AfricInvest, Kenya.

AfricInvest turns 25 years old next year and has branches in seven countries in Africa, with the oldest office and headquarters in Tunis, Tunisia. Kenya operations began in June 2009.

AfricInvest currently has over € 1.5 billion under assets in various funds. The firm has closed over 190 transactions since 1994 and overseen 90 exits.

At a time when there is global convergence in all aspects of business, George believes it is no different here in Africa, where AfricInvest continues to grow. Companies of all kinds are taking advantage of foreign markets and technology to grow and family owned businesses are also looking to create value in their businesses with a view to transcend generations and innovate.

Regional trends in private equity

The private equity landscape in East Africa has evolved significantly over the past 10 years. At the time AfricInvest set up in East Africa, most of the existing private equity firms were foreign-based, had a "fly in" model for their operations in Africa and hired mostly expatriate managers. This has significantly changed over the years with more pan-African private equity firms run by local professionals seeking to transfer knowledge across various sectors, influence policy within the governments and mobilise investment flows in the regions.

AfricInvest's approach is to roll up their sleeves and work with management and boards to improve investee businesses. According to George, it is important not only to understand the business fundamentals, but also to spend time understanding the personalities of the owners, families, board members, shareholders, management and external stakeholders of family businesses. "Relationship building with the owners and management is everything!" he says.

George believes that there is still a gap in transaction advisory skills in the East African market for family owned businesses, particularly in relation to "family consulting". Good family business advisors are hard to come by: some lack the knowledge, depth or appreciation of the unique challenges of family owned businesses, while others may overprice consultations and complicate simple deals. In recent years, family business owners are becoming increasingly proactive in directly approaching private equity firms for services or partnerships.

Preparing for private equity investment

George says that many family owned businesses do not prepare their businesses sufficiently for private equity investments. Preparation tends to start too late and hiring transaction advisors as a last resort does not help much. George advises that family businesses start good practices much earlier, such as by ensuring that there are good governance structures in place with clear decision making guidelines and that there is an accountability matrix for the family members running the business.

George observes that the typical investment life cycle of five years was sufficient to add value and grow typical mid-sized and larger companies outside the financial services sector. Some organisations in financial services require longer life funds because of dynamic market conditions in East Africa.

In some cases, private equity funds may exit to each other, a process referred to as "secondary transactions" providing more time for the investee businesses to stabilise.

Bringing in the value of the younger generation

George has considerable experiences with NextGens in family businesses. "I have come across instances where NextGens, especially in this region, were not keen to plug back into the business after completing their business degrees abroad. The owners then resorted to engaging private equity fund managers to run the businesses," he recalls. In these cases, private equity firms can help to ensure channels of communication are open for NexGens and all stakeholders, rationalise the skills required from the NextGens as they enter the business and clarify existing decision making processes.

Timing is always critical to a successful transition of NextGens, according to George. "Family offices" are increasingly helping to manage family investments, address inheritance issues and transition from emotional discussions at the family dinner table to more structured and documented conversations.

'The markets across the continent differ, and constraints are experienced differently in all these areas," George says. "Corruption is still a problem in most African economies," he says although he also believes that Kenya seems to be addressing corruption publicly and that this will help to strengthen the business operating environment for family businesses and private equity firms alike.

Those seeking to maximise growth need a partner who offers more than money. The right partner will help improve governance and procedures, add a more challenging board member, expand the network and eventually help prepare the business for a successful exit or succession. An increasing number of family businesses might be starting to view private equity as a smart choice.

At the same time, private equity businesses are sitting on significant amounts of money — but with few good deals to invest in. Investors are now increasingly looking for opportunities with family businesses, which are attractive because they tend to be stable — and often undervalued. To attract these family companies, private equity firms are acting in a more collaborative way, focusing on building operational value and making portfolios bigger, stronger and more reliable instead of just trying to generate quick returns.

This means that family businesses have an opportunity to learn more about the benefits private equity can bring.

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Access to funding – a post rate cap conundrum

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September 2016 brought with it one of the most significant changes to Kenya's banking landscape. Amendments to the Banking Act introduced a floor to deposit rates applicable on customer funds held by banks and more fundamentally, a cap on lending rates in local currency.

While it was expected that the "cheaper" borrowing rates would ease the burden for borrowers, in reality the majority of banks have taken a more prudent approach to lending, being more selective about who they lend to and the limits applied based on their perceived risk profile, and to some extent, preferring to lend to government through the purchase of Treasury bonds and bills.

The impact on businesses, in particular small to medium sized enterprises has been somewhat adverse. The preference for government paper in an environment where government has also demonstrated an appetite for the issuance of debt has constrained the liquidity available to other segments of the economy. As a result there has been a domino effect on businesses, with suppliers and customers struggling to access funding in particular for working capital, even when security packages are enhanced to try and twist the arm of lenders.

Naturally, distress has been the result, a phenomenon experienced by many entities across the value chain – including family businesses.

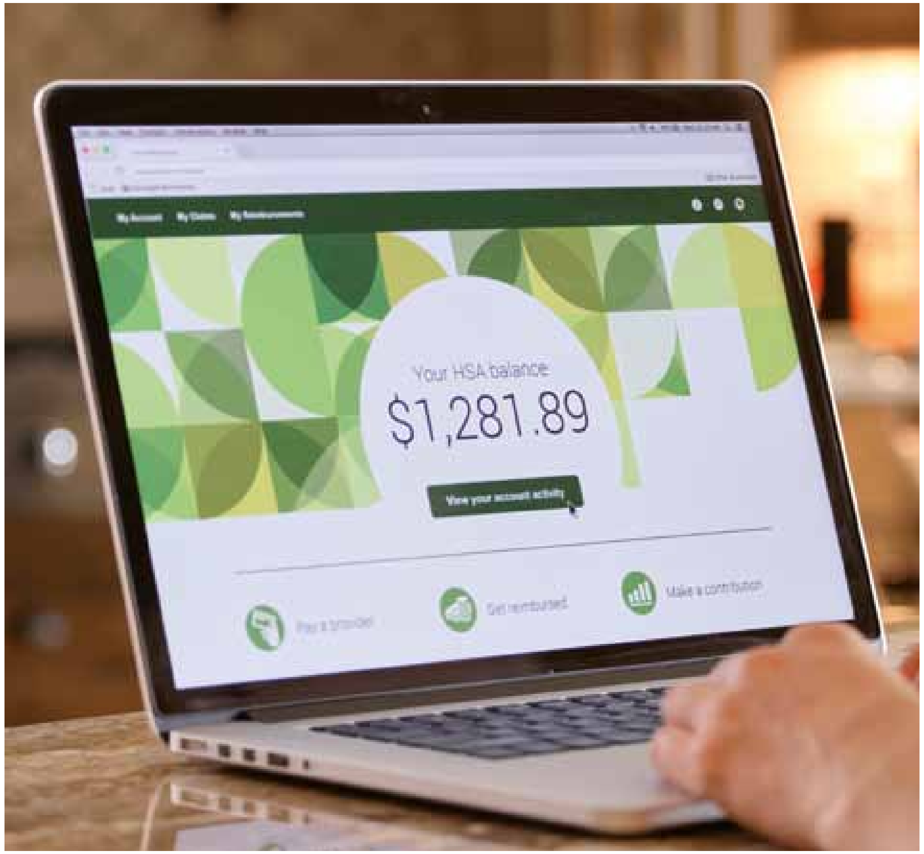
Entrepreneurs have begun seeking alternative forms of capital as opposed to pure bank debt. Private equity has been one option but with the extended electioneering period in 2017, potential investors were shy to move in until political temperatures cooled. Vendors were also worried about valuations in this period and preferred to hold off until the economic environment improved. The high profile administrations and distress of large players in the retail sector have also tempered the appetite for deals and contributed to lenders taking a more cautious approach.

In this environment, there has been an influx of activity from credit funds providing funds by way of mezzanine finance and targeted at resolving working capital constraints. They have needed to earn the confidence of companies unfamiliar with this model. With the increasing number of deals and a better understanding of risk profiles, more funders are now coming to the table from South Africa, the Middle East, Europe and beyond.

The micro lending market, which (for now) remains free from the rate cap, has been an alternative, in particular for smaller businesses, but their size and liquidity does limit the quantum of debt and tenors that they can extend. Other parties have resorted to seeking funding from financiers offering high cost, short tenor and non-commensurate security packages. While considered a short-term solution, very often these arrangements end up being punitive to the borrower.

Development finance institutions, which by mandate should not technically compete with commercial lenders, have become a popular source of funding, in particular to parties that are able to generate a portion of their revenue in hard currency sufficient to repay borrowings. Their long tenors have been particularly attractive to manage cash flows and usher projects towards a smoother path to maturity. Regional and international players continue to increase their presence in the market, targeting trade finance and project finance arrangements. This has put some pressure on commercial lenders, who have recently been seen offering structured pricing and tenors not too different from those of development finance institutions.

What's the way forward? Businesses have found themselves in a situation where they need to reconsider their business model, seek equity injections from shareholders or other interested parties, aggregate borrowings and term out debt facilities and where possible, seek cheaper funding. There is no one solution that will provide adequate capital but agile and resilient businesses will ride the current wave better than others.



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Fraud and corruption in family-run businesses – is the bond strong enough?

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PwC Kenya

Like any other business, family run businesses are at risk of fraud by employees and external parties. However, there is one category of fraud that is unique to family businesses: fraud by the owner or one of the owners. This type of fraud occurs because of certain unique, enabling elements within family-run businesses.

One of these elements is trust. The typical family-owned business may operate, day-to-day, on the basis of high levels of trust. Another enabling element is what we may term “control issues”. The principal owner of a family-owned business, especially one who has successfully grown the business from a small outfit to a respected – even listed – company, commands respect. Other elements that can enable fraud in a family-run business are related to a difficult business environment characterised by profit warnings and companies operating with sub-optimal capital and liquidity.

In this kind of environment, it is possible for a family-run business to slide down a “slippery slope” of increasingly blatant forms of fraud by the owners. We shall examine some of the forms of fraud below.

Drawings

Drawings are withdrawals of cash or other assets from a business by the business owners. Drawings, done correctly, are not a bad thing. The important thing about drawings is that they by definition reduce the owners’ equity. However, the business owners may not want to account for these amounts in the correct way, and could mask the true nature of the value extraction from the business. Incorrectly accounted-for drawings may well represent the first step down the slippery slope of fraud in family-run businesses.

False expenses

The line between business expenses and personal expenses, in the mind of a business owner, could become quite blurry. Suppose a Chief Executive travels out of the country to meet with important stakeholders overseas. Which of their incurred expenses are personal, and which ones are business-related? Further, when an executive sees oneself as the business, this rationalisation can lead them to loading all of their personal expenses on the business and feeling quite legitimised in doing so. This thinking may represent another step down the slippery slope.

Climbing up the Income Statement

It is profit after tax, typically, from which dividends are paid. The owner of a loss-making company would have no Profit After Tax from which to make a dividend distribution. Such an owner may choose to insert themselves higher and higher in the income statement, by becoming a supplier to the loss-making business at either Expense or Cost of Sales level. This enables them to extract value before a profit has been realised. If transactions between related entities are not done at arm's length, such as if, for example, the related entity supplier to the loss-making business charges that loss-making business a higher-than-market price for its supplies, this could very well represent fraudulent value extraction.

Payroll irregularities

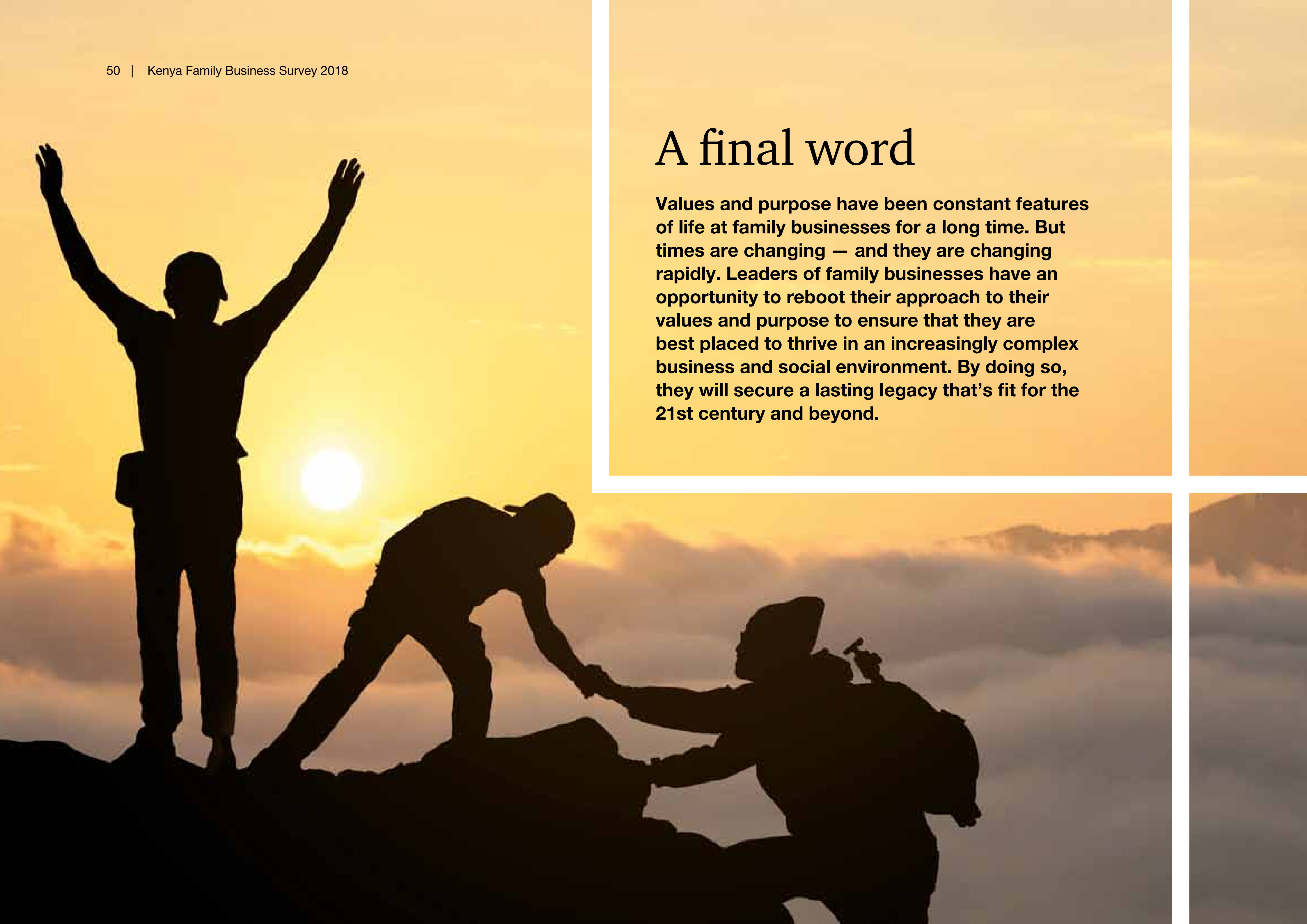
A well-run family business should pay its directors salaries. However, these salaries should be reasonable and should not be a burden on the business. In instances where companies with such employment benefits are family-run or owned, the risk of fraud can be higher.

Financial statement fraud

Eventually, these misdeeds will catch up with the business, and the owners may be forced to request their accountants to hide important financial information, or to materially misstate it, leading to financial statement fraud. Another way this may happen is when a family member is put into a management position, and is not fully qualified for the job. This in itself is risky, but if the family member feels pressure to perform, this pressure can lead to their deliberately misstating financial information to mask their underperformance.

Many of the pitfalls outlined in this article can be avoided by ensuring:

1. Owners hold regular meetings to strengthen interpersonal bonds, and to ensure that there is agreement on key matters, such as broad strategy and/or key management personnel hiring decisions;
2. Family-run businesses are run independently and with professional management advice past a certain size;
3. Key elements of corporate governance (such as an empowered internal audit department that reports directly to the Board Audit Committee, and a strong and well-enforced system of internal controls) are established.



A final word

Values and purpose have been constant features of life at family businesses for a long time. But times are changing — and they are changing rapidly. Leaders of family businesses have an opportunity to reboot their approach to their values and purpose to ensure that they are best placed to thrive in an increasingly complex business and social environment. By doing so, they will secure a lasting legacy that's fit for the 21st century and beyond.

We believe the time has come for family businesses to view values, purpose and legacy through a lens that may be quite different from the one through which they may have been viewed historically. That's because the world is evolving at a faster rate than ever, and the assumptions that may have served a family business well over the past generation or two may not stand the test of today's challenges.

In addition, an enormous transfer of wealth is poised to take place in the next decade as family businesses in Kenya and globally, deal with a generational transition on an unprecedented scale.

For many family businesses, this change will introduce a multi-year period in which there will be a compelling requirement to revisit and reboot their approach to values, purpose and legacy, and to position themselves competitively for the 21st century.

There is a wealth of collective experience in the family business community that demonstrates how a new approach can pay dividends, and we believe that our case studies in this publication help to bring this to life and will stimulate new ideas.

We have identified a few key principles that may guide you on your individual journey:

- **Ensure that the next generation is deeply involved.** Their views are likely to help bring greater alignment between family values and business values because the members of the next generation deeply understand some pivotal concepts: the pace of disruption, the impact of digital technology and the meaning of purpose. Their own way of 'horizon scanning' — seeing what's around the corner — should be properly recognised and incorporated into your strategic planning. One quick win to consider: invite younger family members to observe board meetings or establish a 'NextGen committee' to consult with.
- **Regard your values and purpose as your unique assets, and as your own social capital.** If used properly, these can make a real difference in distinguishing your family business. They can also enhance customer and employee loyalty, as well as increase shareholder commitment and financial returns. To bring your unique competitive advantage to life, you should codify your values in writing, embrace them, include them in your strategic planning, and communicate them effectively. Doing so will not only bridge the family interests and business needs, but also provide guidance on better decision making for the long term.
- **Think about the composition of your board in relation to how you apply values and purpose.** Boards play a critical role in determining how to practically measure progress in the application of values and purpose, as well as ensuring that appropriate behaviours are recognised and rewarded. Having the correct balance of family and non-family board members is essential in achieving the appropriate level of board objectivity to do this successfully. An effective board with the right skills and experience will also reap benefits in how the business deals with disruption in areas such as digitalisation, as well as in shining a spotlight on the importance of having a proper strategic plan.

"The message is clear: adopting an active stance towards company values generates practices that pay off in real terms. A commitment to a clearly defined set of values can act as an 'inner compass' for a family business as it navigates challenges of technological and competitive disruption."

- Peter Englisch, Global and EMEA Family Business Leader, PwC Germany

What is clear is that family businesses that take a more formal and collaborative approach to the determination and application of their values and purpose tend to post more impressive growth and performance statistics over the mid- to long-term. It is also clear that new imperatives are prompting the need for family businesses to reconsider their resilience and effectiveness.

At PwC, we are committed to working with family businesses to help revisit how values, purpose and legacy should be viewed and effectively deployed in the current environment of unprecedented challenge and rapid change.

Research and methodology

Between 20 April 2018 and 10 August 2018, 2,953 semi-structured telephone, online and face-to-face interviews took place with senior executives from family businesses in 53 territories worldwide. In Kenya, a total of 46 family business owners and Next Generation respondents participated in our survey.

The interviews were conducted by Kudos Research, in the local language by native speakers, and averaged between 30 and 40 minutes. The turnover of participating companies ranged from US$5m to more than US$1bn. All results were analysed by Jigsaw Research.

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 158 countries with over 250,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at **www.pwc.com/ke**

In Africa we're the largest provider of professional services with close to 400 partners and over 9000 people in 34 countries. This means that we're able to provide our clients with seamless and consistent service, wherever they're located on the continent.

Our in-depth knowledge and understanding of African operating environments enables us to put ourselves in our clients' shoes to offer tailored Tax, Assurance and Advisory solutions for every business challenge.

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In East Africa, our member firms in Kenya, Uganda, Rwanda and Tanzania work to build trust in society and solve important problems.

PwC in Africa

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