Global Family Business Survey
Focus on Malaysia

Up close and professional: the family factor

pwc

Malaysia
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Contents

Foreword

Successful family-run businesses in Malaysia are relatively in their early days unlike their counterparts in Europe or North America who have endured for five generations or more. The majority of the active Malaysian family businesses are in the second or third generation stage. As with most transition processes, there will be challenges – emotional and personal. However, the inaugural PwC Malaysia Family Business Survey 2014 has shown us that the challenges faced by family businesses in Malaysia and around the world are not very different.

PwC has worked extensively with family firms across the world and in Malaysia where we can see that the very distinctive qualities which make a successful family firm - entrepreneurial energy and determination - well positions them to achieve extraordinary growth. However, the very fact that the family element is intertwined with the business element can be a double-edged sword – where family disputes can surface, jeopardising the long term success of the business.

Which is why, the 2014 Global Family Business Survey focuses on the need to professionalise both the business and the family.

Our report looks in detail at the responses of Malaysian family businesses as compared with global responses, which generates some interesting similarities and differences. We hope that you will find the reported findings and insights from the survey thought provoking.

Fung Mei Lin
Senior Executive Director
PwC Taxation Services Sdn.Bhd

So, what is on top of the minds of Malaysian family firms?

Globally, we talked to nearly 2,400 family business decision makers in over 40 countries over the last few months.

In Malaysia, we spoke to 50 family business decision makers and found out that the results here generally line up consistently alongside our global results – certainly in terms of recent commercial performance, optimism for growth, overall personal and business goals and future plans in terms of passing the business on.

Here is a snapshot of our survey findings in Malaysia.

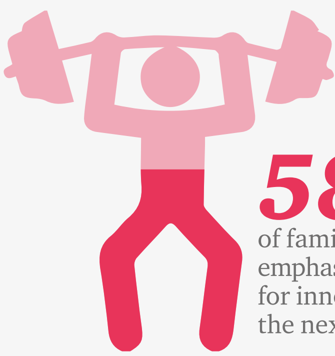
Growth

64% recorded growth in sales last year

66% aims for steady growth over the next five years

18% aim to grow quickly and aggressively over the next 5 years

Key challenges



58% of family firms emphasised the need for innovation over the next 5 years

52% predict fierce competition

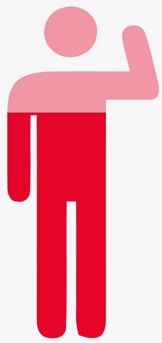
Succession planning appears to be a key challenge to businesses in the short and long term respectively at **16%** and **48%**

Professionalising

Moving to the next level

46% feel a greater need to professionalise

Across the world, more family businesses are seeing the value of bringing in professionals to run their businesses. The loss of control compensated by an increase in discipline is inevitable to ensure the continuous success of the business.



70% have non-family members on board

Professionalising the family

Where the elements of "head" and "heart" collide, families often postpone professionalising the family as it raises too many intractable issues.

the business

Succession

38% are looking to **pass on management** to the next generation

36% are looking to **pass on ownership** but bring professional managers in

Only **16%** have a formal succession plan

The number of stakeholders increases as the business grows, and so does the potential for conflict. Transition from the first to the second generation is the easiest. After that it only gets harder.

18% of family firms are looking to sell and exit their business

Skills and talent

Key issues

Staff recruitment appears to be the key challenge in the short and long term respectively at **60%** and **58%**

Retention of key staff seems to be a heightened issue as **44%** of respondents listed it as a key challenge

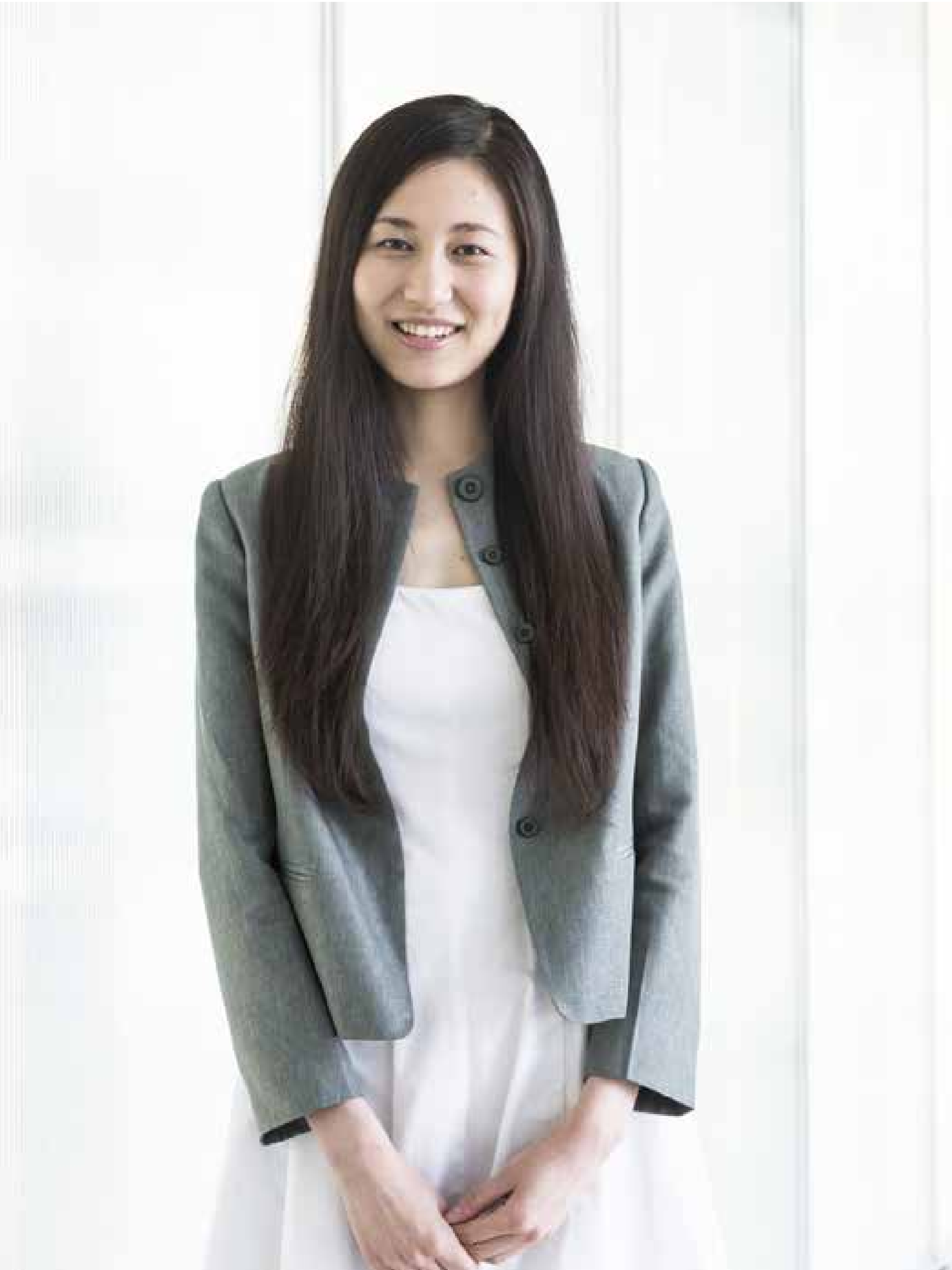
Conflict: Head and heart of the matter

34% have a shareholders' agreement

20% have family councils to manage any conflicts and to provide advice on issues faced

Only **28%** of family firms have a conflict resolution mechanism in place

Taking the long view: The special qualities of the family business



The family firm is one of the oldest and most enduring forms of business organisations, and has been responsible for the creation of global brands like Guinness, Walmart, Samsung and Ford. They still make up around 30% of the world's billion dollar corporations and deliver up to 90% of global GDP.

So the family business model is alive and thriving, but the success rate for individual family businesses is not so encouraging – only around 12% make it to a third generation, and the number is as low as 1% for those surviving beyond a fifth.

In many cases, it is family issues that eventually cause the failure of family firms, and we will look in detail later in this report at what those issues are, and how family businesses can address them. But we will begin with an examination of the special qualities of this approach to business, and the advantages of 'keeping it in the family'. We will draw on the findings of this year's PwC Global Family Business Survey, and look specifically at the findings for Malaysia.

Longer-term thinking and 'patient capital'

With no outside shareholders or pressure to make quarterly earnings reports, the family firm is free to take a much longer-term approach to decision-making. Investments are typically assessed in terms of decades rather than years.

55% of the respondents in this year's global survey agree that family businesses take a longer view, and 73% believe the sector makes a valuable contribution to a balanced economy. Malaysian respondents were not quite so positive, at 40% and 54% respectively.

Quicker decision-making and more flexibility

In general, family businesses often believe that they are more agile than their multinational competitors, and that means they can move quickly to identify and seize market opportunities. 69% of global respondents and 64% in Malaysia agree that decision-making is faster in the family firm.

An entrepreneurial approach

59% of the global respondents think that family businesses are more entrepreneurial than other sectors of the economy, and that figure is slightly higher in Malaysia, at 62%. Likewise most of those surveyed believe that family businesses have the ability to reinvent themselves with each new generation – 56% globally and 68% in Malaysia.

A commitment to jobs and a responsibility to the community

78% of those taking part in the global survey believe that family firms feel a stronger sense of responsibility to create jobs, although the figure for Malaysia was noticeably lower, at 58%. 72% globally feel that they work harder than multinationals to keep their staff during bad times, and many believe this translates into greater loyalty and commitment from their employees. 59% of global respondents agree that community initiatives are important to the family firm, but this figure is down markedly from 2012, when it was as high as 70%.

The figure for Malaysian respondents in 2014 was 68% in relation to a strong sense of responsibility to support community initiatives.

A more personal approach to business built on trust

73% of global respondents consider that the family firm is notable for the strength of its culture and values, and many believe that they win business because they are closer to their customers, and have earned their trust, often over many years. Most Malaysian respondents also agreed (70%).

It's clear that many family businesses consider these distinctive qualities to be a source of real competitive advantage, but other aspects of this unique business model can sometimes hamper growth: a longer-term approach can result in an unwillingness to take risks, and 36% of global respondents said that family firms are less open to new ideas than their peers (38% in Malaysia).

So as we emerge from the global downturn, how healthy is the family firm around the world and also Malaysia?

The new economy: More competitive, more volatile

Across the world, the family business sector is in good shape. 65% report growth in the last twelve months, and 70% expect to grow steadily over the next five years. At a global level, 15% are aiming to grow aggressively over the next five years compared with 12% in 2012.

Family businesses in Malaysia report very similar figures, with 64% recording growth in sales in the last year, and 66% expecting steady growth over the next five years. A slightly larger number than the global average predict aggressive growth (18%), and every respondent who is expecting their business to grow is confident that this growth will be achieved.

At a global level, the number of family firms citing the general economic situation as their prime external challenge for the forthcoming year has risen from 54% in 2012, to 63% in 2014. 60% of Malaysian firms also say that this is a key issue.

As the chart on page 11 shows, Malaysian firms are generally slightly more concerned than the global average about government regulation, competition, exchange rates, export markets and the price of raw materials.

"We are very exposed to the developed markets in US, Europe and China, so stability in those markets is important"

2nd generation

Turning to internal challenges, some of the Malaysian results differ more markedly. Firms in our market are significantly more concerned about staff shortages over the next year than global firms as a whole (60% as against 49%), and much less preoccupied by issues such as corporate reorganisations, and business and product development.

Innovation is at 68%. Succession planning and dealing with family conflict are of greater concern here. Succession planning appears to be a key challenge to 16% of businesses in the next 12 months and 48% responded to be a key challenge in 5 years time. We will look at these issues in more detail later in the report.

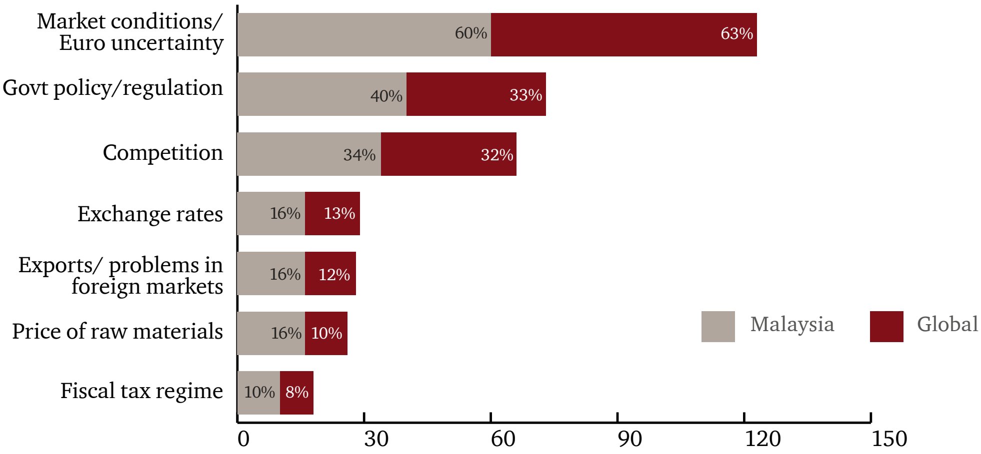
"There are concerns about government policy in relation to the economy in general and the recruitment of foreign workers"

3rd generation

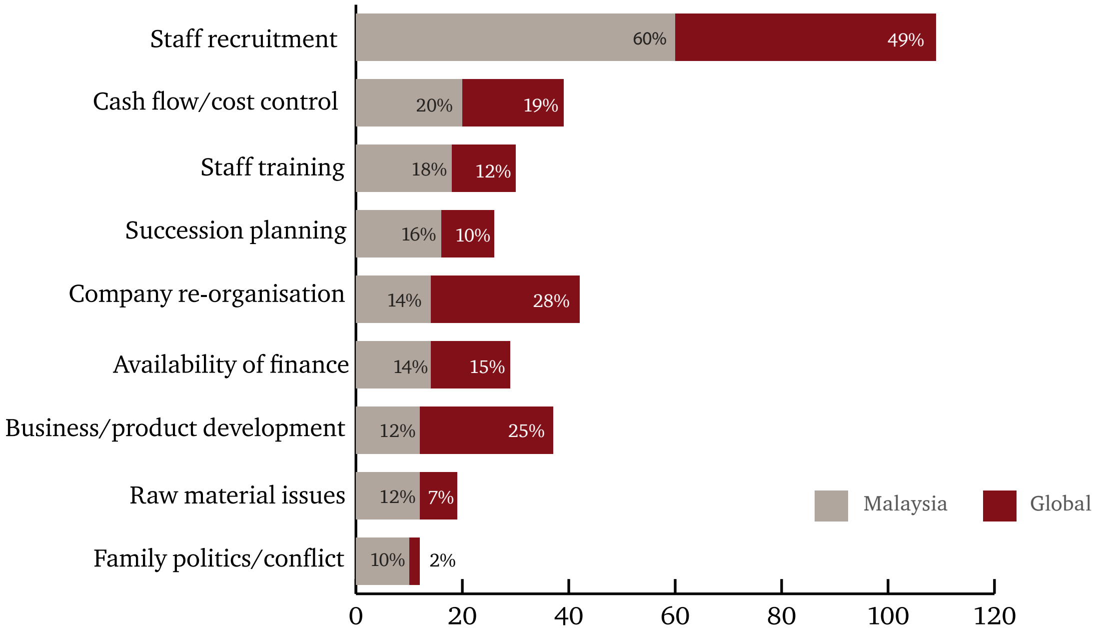
60%
of Malaysian family firms say the general economic situation is their prime external challenge for the forthcoming year.

Alarmingly ***10%*** *of Malaysian family firms predicts family politics and conflict as a key issue in the next 12 months.*

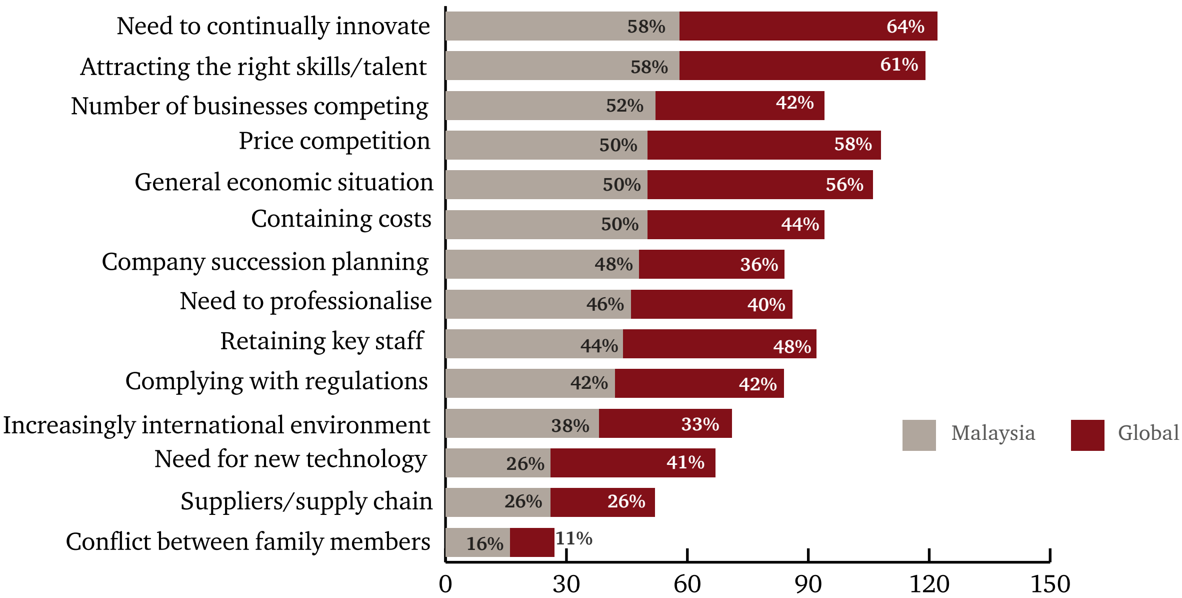
Key external issues in the next 12 months



Key internal issues in the next 12 months



Key challenges in five years time



When the time horizon is extended from one year to five, the key concerns in Malaysia are the need for innovation (58%), attracting the right skills (58%), market competition (52%), price competition (50%), and the general economic environment (50%). Malaysian firms are more concerned about succession planning than the global average (48% as against 36%), and feel a greater need to professionalise (46% compared with 40%).

New markets overseas:
The international opportunity

This year's global survey shows that 68% of family businesses are exporting, with overseas sales accounting for about a quarter of turnover for all respondents. Around three quarters of those surveyed across the world expect to be exporting by the end of the next five years, and predict this will account for over a third of all sales. Those businesses which are particularly keen to grow internationally are those pushing for aggressive growth, those with a turnover of more than $100m, and those in the manufacturing and agriculture sectors. They also tend to be younger businesses in their first or second generation.

However, some aspects of the detail behind the data are more ambivalent. Even if exports are likely to account for a larger proportion of sales, few family businesses expect to be exporting to a significantly larger number of countries than they do now, and most tend to stick to neighbouring territories or those with the same language and a similar culture. This suggests that they lack either the skills or the confidence to break into entirely new regions - many would probably need to hire in outside talent to bridge that gap, and they may well be missing out on new sources of growth as a result. It can also be far more expensive to export to more distant markets.

Looking specifically at Malaysia....

Our market is somewhat lagging the global trend, with exports accounting for only 19% of sales compared with 25% globally. The Malaysian figure is expected to grow to 30% over the next five years, but this will still slightly lag the global equivalent of 32%. Malaysian family firms are a good example of the sector's tendency to expand to adjacent territories where the culture and way of doing business is similar.

90%

of growth is likely to come from the Asia Pacific region, especially China, Indonesia and Singapore.

In the case of Malaysian firms, there are also several additional factors at work:

- Asian markets represent better export prospects than Western countries where growth has slowed, and a rapidly rising Asian population is also fuelling demand.

Significant government incentives such as tax holidays, investment tax allowances, regional centre tax incentives etc. make it more attractive for Malaysian family businesses to focus on new markets closer to home.

"We are concentrating on Vietnam, Bangladesh and Thailand. Hopefully the political volatility will improve otherwise our growth will be slow"

1st generation

Keeping pace with change: The innovation imperative

So even if the worst of the downturn has passed in most economies, across the world, price pressures remain intense, customers are becoming more demanding, and margins are tight; in short, family businesses are having to accept that the conditions they enjoyed before the recession are now unlikely to return. This is partly a reflection of the new economic reality, but it's also symptomatic of the more profound shifts that are underway as a result of global megatrends like demographic change, globalisation, urbanisation, and the digital revolution, which are making the business landscape more fluid and more disruptive than ever before.

In our 17th Annual Global CEO Survey, 81% of the respondents across the world cited technological advances as one of the top three global trends most likely to transform their business over the next five years. Exploiting the full potential of digital includes everything from how the business is run internally, to how it reaches its customers externally.

Family businesses likewise recognise the growing impact of digital technologies, with 79% of global respondents putting this among their top three priorities. 72% recognise that they will have to adapt the way they operate externally, and organise themselves internally, to exploit the full opportunities of digital and avoid being overtaken by more advanced competitors. 43% also accept that they will need to attract the right talent to do this, which raises the question about whether the remainder are fully aware of the extent of this challenge. Malaysian family firms' responses are even stronger - 82% of respondents in our market recognise the organisational changes they will have to make, and 54% expect to need new recruits to help them. In fact Malaysia has one of the highest scores across the world in terms of understanding the commercial potential of digital, scoring 68%, alongside powerhouse emerging markets like China (78%) and India (69%).

68%

of Malaysian family firms understand the commercial potential of digital, one of the highest scores in the world.

Innovation in its widest sense remains a key concern for family firms across the world in 2014, as it was in 2012, with 64% citing this as a high priority, compared with 62% in 2012. Those businesses which are pressing for aggressive growth are more likely to see innovation as a key ongoing challenge. And yet even though innovation is given such prominence, the experience of our own PwC teams around the world suggests that many family firms are still reluctant to change. Even though family businesses continually claim that one of their strengths is their ability to reinvent themselves - 56% of global respondents said so this year, up from 47% in 2012 - there are not very many examples of firms that have actually done so.

"Family firms either don't want to reinvent themselves, or can't. In practice they find it hard to divest legacy businesses, and only expand or diversify within a narrow range."

2nd generation

There is also evidence that both growth and innovation are a lower priority for businesses in their third or later generations, who place more emphasis on ensuring that the business remains in the family. This could suggest that these firms risk becoming complacent and uncompetitive. Though it's easy to see how the psychological factors that come into play as the business matures could make those running them more risk-averse and less entrepreneurial. Later generations don't want to be the ones who 'lose the farm', and the number of family members dependent on dividends can be very large for a business that has been in existence for 50 or 60 years.

Balancing commercial and personal priorities:

'Head' and 'heart'

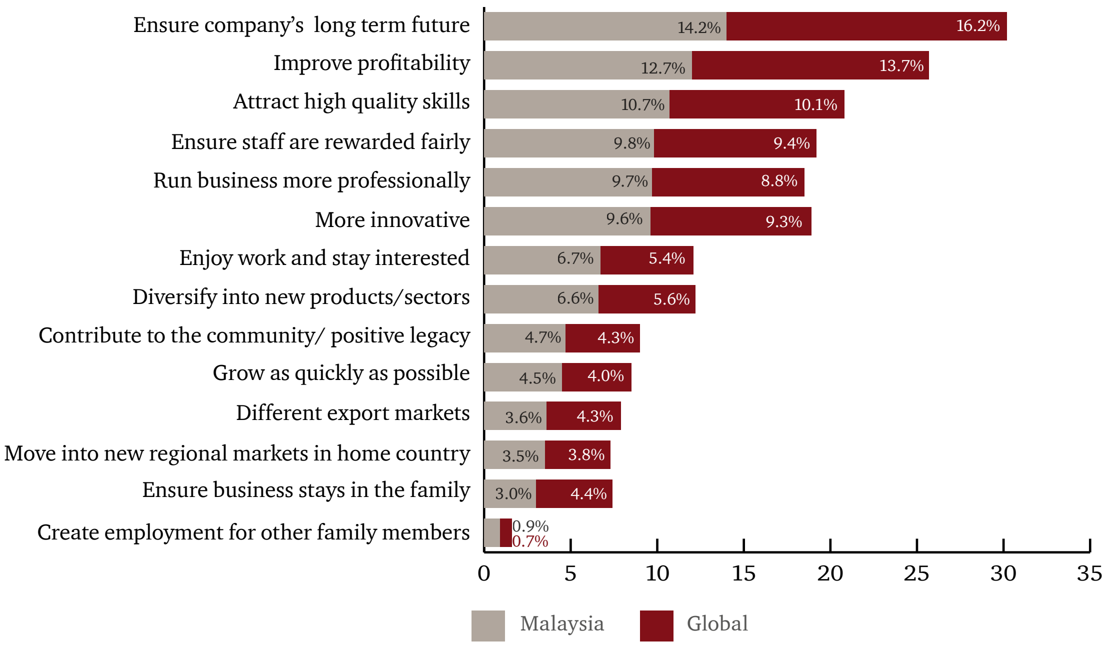
This year's global Family Business Survey suggests that the new economic pressures are forcing many family firms around the world to re-think their strategies and take some tough decisions. In many markets, this is sharpening the tension already inherent in the family business model between family concerns on the one hand, and business objectives on the other: what you might call 'head' and 'heart'.

On a global level, family businesses have become much more hard-headed since the last PwC survey in 2012. The most important priorities are to remain in business and improve profitability while the 'heart' issues of family and community come out very much lower. In the 2012 global survey, 70% of those questioned said they felt a strong sense of responsibility to support community initiatives, but that number is down to 59% this year.

As the chart on your right shows, the picture in Malaysia is broadly the same, though it is perhaps surprising that keeping the business in the family is slightly less important than the global average.

Relative importance of personal and business goals over the next 5 years

Respondents were asked to assign a % score for each, adding up to 100 in total



The impending challenges faced by family businesses, whether external or internal, require them to challenge their status quo. Conventionally, family businesses tend to take matters into their own hands, but perhaps it is time for them to consider professionalising their business as it helps open up new commercial opportunities, allows businesses to innovate better, diversify more effectively, export more, grow faster and be more profitable.

Professionalising the business:
Moving to the next level

One area where Malaysian family firms have higher scores than the global average is in relation to the need to professionalise the business

46% as against ***40%***

Professionalising the business is gaining ground as a key concern for family firms around the world, driven by an almost perfect storm of competitive pressure, rising costs, and global megatrends. This emerged very strongly in PwC's Next Gen survey[1] earlier this year, when a number of the upcoming generation told us they want to formalise and modernise the business when they take over. In the 2014 Family Business Survey, 40% of global respondents agreed that this is a key challenge over the next five years, and a fascinating picture emerges when that figure is broken down.

It's the younger and more ambitious businesses who are more likely to cite professionalising the business as a goal, and are more aware of the risks and opportunities of the move to digital technology. They're more likely to be looking at a possible private equity exit strategy, and will know that these investors will look for a well-managed and disciplined operation. This applies equally to those looking to undertake an IPO.

Professionalising a family firm is not about process for its own sake, or about weighing down the entrepreneurial flair that launched the family firm in the first place. It's about giving structure and discipline to that vision and energy, so that family firms will be able to innovate better, diversify more effectively, export more, and grow faster.

This also holds true for Malaysian family firms. For them, the professionalising agenda is all about ensuring they can continue to grow effectively once they reach a certain size, when it is no longer feasible for one person alone to run the business. Some firms are also concerned about ensuring that the family does not dominate decision-making. Many firms in our market are now benchmarking themselves against other corporations in areas such as business processes and governance, which we will look at in more detail in the next section.

"A key challenge is professionalising the firm – so we can move to the next level"

2nd generation

"We need to find the right professionals to assist us in running the business and to help with the internal restructuring and change of mentality within the company"

2nd generation

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

Professionalism in practice: Processes, governance, skills

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

There are ***three distinct*** *areas where family firms across the world are feeling the need to professionalise their operations.*

"We need to streamline our systems and standard operating procedures"

1st generation

Processes

Though there are some family firms around the world that manage without formal business processes – especially first-generation entrepreneurial start-ups - most larger firms now have documented procedures and policies, if only to comply with external regulation in areas like Health & Safety and employment law. Likewise many are automating their operations and increasing their use of IT as a way to improve productivity and efficiency, and to counter the cost pressures we have already discussed. They are also being more systematic and structured in their approach to sourcing, again as a result of rising costs.

"We need to have more skilled staff and to improve communications within the company"

2nd generation

Governance

Across the world, the corporate governance of the family firm has improved since 2012 - more family businesses are seeing the value of appointing experienced non-executive directors, though it can be hard to find and recruit people with the right expertise, as family boards are often perceived to be more problematic than those of conventional companies.

Malaysian family firms are also improving their governance processes. In some cases this is driven by the recognition that they need a 'safety net' should unforeseen circumstances occur, for example, the sudden death of the founder. They also value the input and objectivity an experienced third party can bring to the business as a non-executive director.

"Over the next twelve months a key challenge will be complying with ISO audit standards"

1st generation

Skills

Attracting and retaining skills and talent continues to be both a concern and a challenge for family firms around the world. As we saw in the earlier chart, 61% of global respondents listed it as a key issue over the next five years (up from 58% in 2012). The Malaysian figure is very similar, at 58%.

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

"We have to work hard to recruit the right talent"

2nd generation

When it comes to skills, 'professionalising the business' frequently translates to 'bringing in professionals to run it'. This is often the right decision, especially when

"It's all about recruiting good people and keeping good people"

2nd generation

the business reaches a certain critical scale, but it can still be a challenging moment for the family firm.

When you bring in outside managers – especially at executive level - the dynamics of the family firm inevitably change.

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

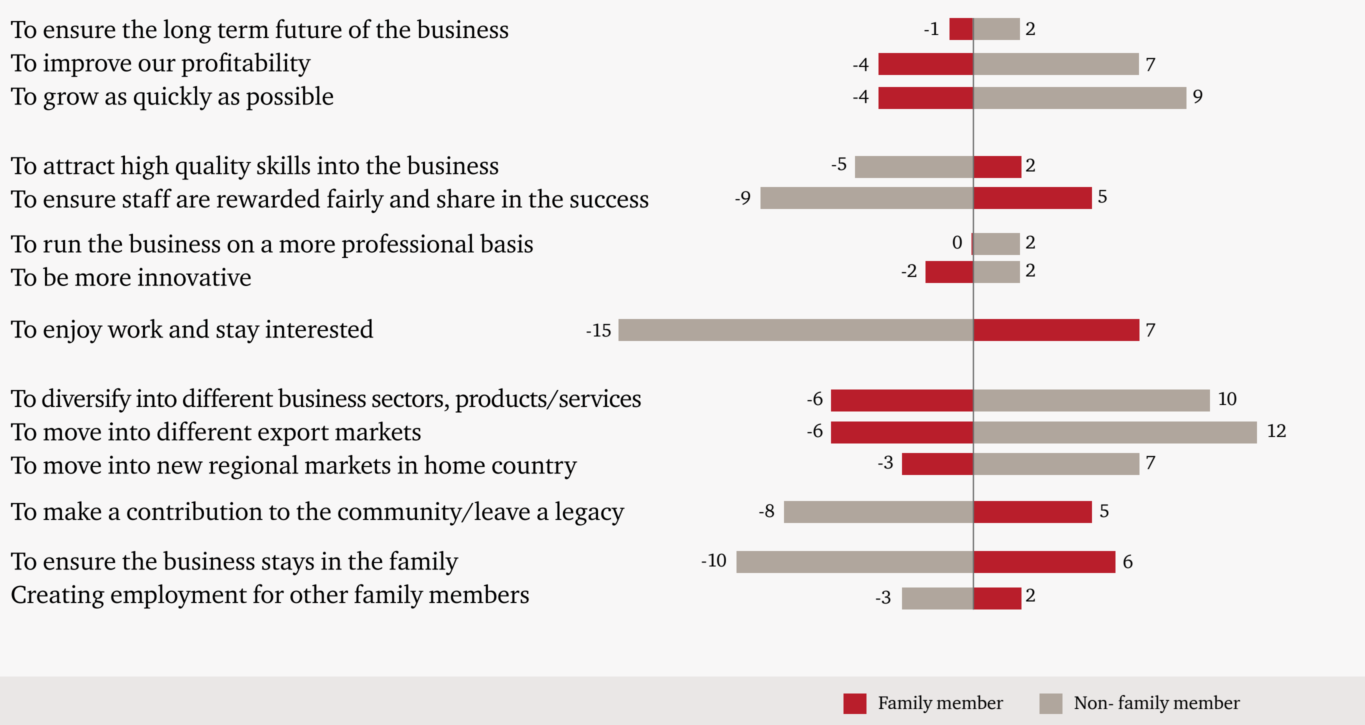
The global survey results show that non-family respondents are much more likely to be pushing for aggressive growth. Innovation, international expansion, diversification, and professionalising the business are likewise higher priorities for them than for family members, who tend to be more focused on family and community, and more concerned about a personal legacy (see the chart on the next page). There are important questions here for family firms, because one interpretation of these figures is that family businesses can either under-perform or lack ambition if they are run by family members, and that this wouldn't be the case with an outsider in charge. A recent PwC study on family businesses in Germany found that more of them are now hiring outsiders at a senior level, and – crucially – those who have done so are growing faster than those who have not.[2]

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

> ***"We need to look at our staff reward system as we realise some of our packages don't meet staff expectations and we want them to stay happy within our company, and have more incentive to work hard"***
>
> *1st generation*

How family and non-family priorities differ

Negative values show results below the average, positive values show results higher than the average



2014 PwC Global Family Business Survey

But recruiting a top-quality CEO is no easy task. As one of our global survey interviewees puts it - "if you bring in senior talent, you have to be able to keep it."

The heart of the matter: Professionalising the family

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

It's the vital family governance piece which must sit alongside the equally important corporate governance structure.

In PwC's recent Next Gen survey, we identified three 'gaps' which can undermine a successful transition between generations: the generation gap, the credibility gap, and the communications gap. The communications gap is particularly relevant here, as the Smorgon Consolidated Industries side panel on page 26 proves. That story also shows that even in a large and successful business, there is a very real risk that family issues will eventually precipitate a crisis for the firm as well as the family, and both may fail as a result. As with so much else, these issues need to be addressed in the good times, because kneejerk decisions made during a crisis rarely result in the ideal outcome.

Only ***34%***

of Malaysian family firms have a shareholder's agreement.

Professionalising the family means putting processes in place to govern how the family interacts with the business.

This includes establishing an infrastructure for decision-making, and formal channels for communications that can supplement the informal ones, and will come into their own during times of tension or difficulty. As in so many other aspects of business, transparency is key. It's vital to keep everyone in the loop, and ensure they feel they have been listened to.

It's about having an agreed set of principles and strategy for the family and the business to protect the family's interests, and safeguard the firm's survival. In other words, it's the vital family governance piece which must sit alongside the equally important corporate governance structure.

This year's global survey shows that an increasing number of family businesses

OBYU Holdings Sdn Bhd is a Sarawak investment holding company principally involved in property development, construction, power, oil & gas and trading & services through its subsidiaries.

Siti Yuhaniz, Mohamad Nadziff and Mohamad Subky work in partnership to take over from the founder, their father, Tan Sri Bustari Yusuf. All three initially gained experience outside before joining the family business.

After having been involved in the family business for almost a decade, there are definitely distinctions that can be drawn between working in a corporate organisation and a family firm as shared by the three of them.

Working in a corporate organisation, roles and responsibilities are much more defined and there are usually established processes and structures in place.

However, in running a family business you may not have sufficient resources and support, which requires you to step up when required to resolve and fill the gaps even if you may not have the right skills and experience yet.

Being involved in a family business, the responsibilities are real and you need to trust and be accountable for the decisions you have made for the business. The decisions you make for the business have an impact on not only the business but the family as well. Ownership and accountability on your actions in running the family business are definitely more real as compared to working in a corporate organisation.

And through that you establish credibility and authority especially with the employees who have been around from the beginning.

A second set of challenge is around building your own team of upcoming professionals to bring in fresh ideas but at the same time striking a right balance with how the business used to be run under the care of the founder and his 'lieutenants'.

It is important that we as a family have a strong family and sibling bond and do not step on each other's toes but work together for the good of the family business.

Running a public listed company poses its own set of challenges as well. We need to balance what is best for the organisation and also its shareholders.

What would be your advice to the next generation who is going to or has started running the family business?

When you first start out, the style and manner of the patriarch may be very different and it is important to respect, accept and understand how things are run which may be different to your style.

Striking a right balance to introduce new and fresh ideas to the business is also important and you need to be open to having dialogues to reach a mutual understanding.

Having regular informal conversations with family members who are involved in the business is definitely useful to close the communications gap and minimise the risk for conflict.

have mechanisms in place to deal with potential conflict, and the survey results show that there has been further progress in this area since 2012. 83% have at least one procedure in place, up from 79% two years ago, and larger firms with sales of over $100m are more likely to have done this (85%). The procedures in question include shareholder agreements, family councils, provision for third-party mediation, and family constitutions. All of these scores have risen since 2012, and across the world, only 17% now have nothing at all.

Looking specifically at Malaysia, 84% have at least one mechanism or procedure in place to deal with potential conflict, compared with 83% globally. However, this headline figure possibly overstates the real state of affairs, as Malaysian firms have fewer of the more rigorous measures that are used by other firms. Only 34% have a shareholders' agreement compared with 54% globally, and 20% have family councils, compared with 32% globally. 16% of family firms in our market have no form of mechanism at all; even though this is in line with the global average, it is nonetheless a cause for concern.

"As my father is now taking a back seat, there will be challenges among the siblings"

3rd generation

However, the all-important issue of succession has still not been fully grasped or effectively addressed by far too many family businesses. 53% of global firms say they have a succession plan in place for some if not all senior roles, but when questioned further, only 30% of those 'plans' are properly documented. Only 16% have something that would qualify as a robust succession process, and that number is still as low as 25% even for respondents aged 65 or over. In this respect, the Malaysian figures are similar to the global average, with 16% of firms having no formal succession plan. Many Malaysian family firms are still in their first generation, and run by patriarchal founders who have no formalised plan. They need to move to the next stage, and ensure their vision of the future is fully documented, shared, and understood.

The family factor: Leaving a legacy

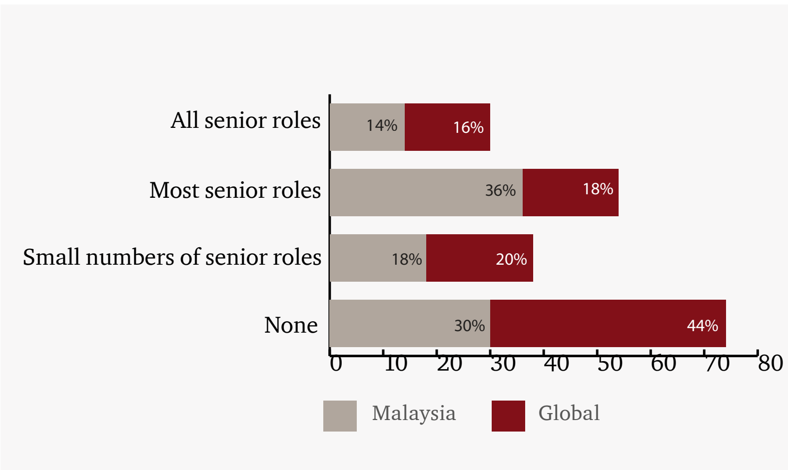
This year's global survey responses illustrate how important it is for those running family businesses to leave something worthwhile behind, or as one Malaysian interviewee put it, "to be remembered."

A higher number of family firms may be putting business issues first this year, but the pull of the personal legacy remains very strong. Many talk about 'longevity', 'integrity', and 'making a difference', and say they want to pass on a business that is stable, sustainable, and profitable. They also talk about creating employment, sustaining the family's values, and supporting the community – all issues that have slipped down their overall list of priorities but come sharply into focus when the emphasis shifts from the professional to the personal. This is clearly a highly emotive issue and is no doubt related to the fact that most family businesses bear the family name.

"Leaving behind an organisation that can last for generations"

3rd generation

Succession planning for key senior roles



Globally and in Malaysia, only a mere 16% of family businesses have a succession plan in place that is robust and documented.

A plan that is not written down is not a plan; it's just an idea, and this is an issue family firms must address with the same commitment and energy as they are devoting to professionalising other aspects of the business. Because without it, the entire enterprise is at stake.

"Succession is a real challenge - I am not sure how soon my son will be ready to take over"

3rd generation

Bridging the gap:
Making a success of succession

The passing of the baton has always been a hazardous moment for the family firm, and never more so than now.

The generation gap

The world has changed significantly since the current generation first went into business 30 or 40 years ago. The 'generation gap' is widening literally as well, as people have children later. This means that the periods between each transition are lengthening, which puts even more strain on a rite of passage which is already fraught with potential problems.

As the business gets older, more potential successors come into play, the numbers in the wider family grow, and the potential for conflict rises. As one of our global interviewees pointed out,

> "The transition from the first to the second generation is the easiest. After that it gets progressively harder. The bigger the family gets, the more likely it is that there will be people who have never worked in the business and don't understand the family or its issues, but are still expecting to receive their dividends. That's bound to cause tension, especially when people react emotionally rather than rationally."

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

The communications gap

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

In the PwC Next Gen survey, 73% said they were looking forward to running the business one day, but only 35% thought that was definite, and as many as 29% thought it, at best, only fairly likely. And in the Global 2014 survey,

41% of those currently in charge agreed that it will be difficult to let go, but that number rose sharply to 64% when we questioned those who will be succeeding them. This is another example of the communications gap that can bedevil the family firm – as Roy Williams and Vic Preisser say in their 2010 book, Preparing Heirs, 70% of intergenerational wealth transitions fail, and many of those failures are due to a lack of openness and transparency.

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

Tan Sri Dato' Chua Ma Yu is the founder of CMY Capital Group, an active investor in global Capital Markets, real estate and hotel development. He also co-founded RHB Capital Banking Group.

The moment of transition proves to be a real challenge and the process of nominating a successor has to be done in a clear and transparent manner, ideally when the patriarch is still around as shared by Tan Sri Dato' Chua.

Succession planning in a family business is sensitive and challenging, especially in large families consisting of 2 generations or more, and if each generation consists of many members.

Many family dynasties have been broken up into smaller entities across many divisions or factions of the family or have completely been lost.

Interestingly, in Asian families, the patriarch plays a significant role reigning in the succeeding 2nd generation with restraint and composure, and in ensuring continuity and unity. This is especially so when he continues to be involved in the management of the family business.

The situation becomes more complex when the 3rd generation emerges, and with each generation member possibly better educated and qualified than the preceding generation. Morale within the established family business and trusted managers are further compromised when 3rd generation members capitalise on their family name rather than on their experience and accomplishments.

What is your advice to others on addressing this succession planning process?

There is no single solution for a patriarch in the division of his wealth and the nomination of a successor. My observations of other historical Asian families have strengthened my view that the most assuring succession plans involves the following:

a. the successor is identified by the family's ultimate decision maker - the patriarch, based on a clear set of criterions

b. the patriarch implements his succession plan while he is still involved in the management of the family business and manages the transition period

c. the patriarch clearly defines the shareholding structure of the family business

The key is for the patriarch to identify a successor who possesses the characteristics and qualifications fit to assume the leadership position within a family business; a person who is able to command the respect, able to maintain strongholds and the family business as a single unified entity without distributing and splitting the wealth and the business.

With the successor identified, the patriarch must set out a clear succession plan when he is still around and is able to manage an organised transition.

An organised shareholding structure is crucial to ensure the identified successor is able to maintain control and to expand the family business.My view is that the successor must be given the majority equity interest whilst other family members are assigned supporting or non-active executive roles, with or without voting rights and be allocated minority equity interest, property and/or cash based on the patriarch's decision.

The subsequent generations shall follow the same principles of selection and wealth allocation in the next succession planning process.

It is however paramount for the patriarch to demonstrate clarity and consistency in his succession planning, and to clearly and effectively communicate his plans to all family members. During the transition period, the patriarch should guide his successor in facilitating a smooth transition, whilst managing succession-related conflicts constructively, and mitigating the risk of sibling rivalry and jealousy.

The credibility gap

This 'professionalising' of the next generation is helping to close the third of the three gaps – the credibility gap. 59% of participants in the PwC Next Gen survey said that winning the respect of their co-workers was one of their biggest challenges, and many of the other issues they cited are closely related to this, including understanding the complexity of the business (44%), being asked to take on a job they feel unable to do (18%), or taking on responsibility too early (9%).

88%

of the next generation said they have to work even harder than others in the firm to 'prove themselves', not only with their colleagues and employees, but also with customers.

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

The family factor: Balancing influence and control

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

This is a good example of the last of the 'four Ls' identified by Mary Barrett and Ken Moores, who was founding director of the Australian Centre for Family Business. They believe you need to learn four key skills to run a family firm: learn business, learn your own business, learn to lead, and learn to let go.[3] The last of these is definitely not the least, and can often be the hardest of all.

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

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

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

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

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

We were excellent communicators on business issues. However, we did not spend enough time discussing family issues. We should have allowed time for family to air their grievances through regular family meetings, which were specifically focused on family, not business issues. Similarly, we continued

'Family education' and professionalisation: Insights from an expert

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

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

What do you believe professionalisation means for the family business, and what are the risks and opportunities for families?

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

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

In your experience, how are family firms rising to the challenge of professionalising their operations?

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

As more families look to pass on ownership but not management of the family business to the next generation, how do they best equip themselves to be responsible and effective owners?

The more we understand about the important role played by the owners in their family businesses, the more we also understand how important it is to prepare and train the family for this task: an informed shareholder is an effective shareholder.

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

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

education' programme.

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

How can families keep the spirit of entrepreneurship alive as the business passes from one generation to the next?

Possibly the greatest challenge facing family companies and their owners is keeping the entrepreneurial spirit alive. This applies today more than ever. Globalisation has greatly accelerated the rate of which things change and life cycles are getting shorter. The old saying, 'It takes three generations to build a business' might soon be outdated, replaced by 'One generation can build three businesses'.

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

Family businesses tell us that two of their biggest challenges are innovation and skills - how do you see family businesses 'staying ahead of the curve' and what issues does this raise?

Innovation, diversification, entrepreneurial spirit and the skills connected with them are becoming increasingly important in the new and dynamic business environment. They have to be instilled in the family, and anchored in the corporate culture of the business.

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

Six ways to address the 'family factor'

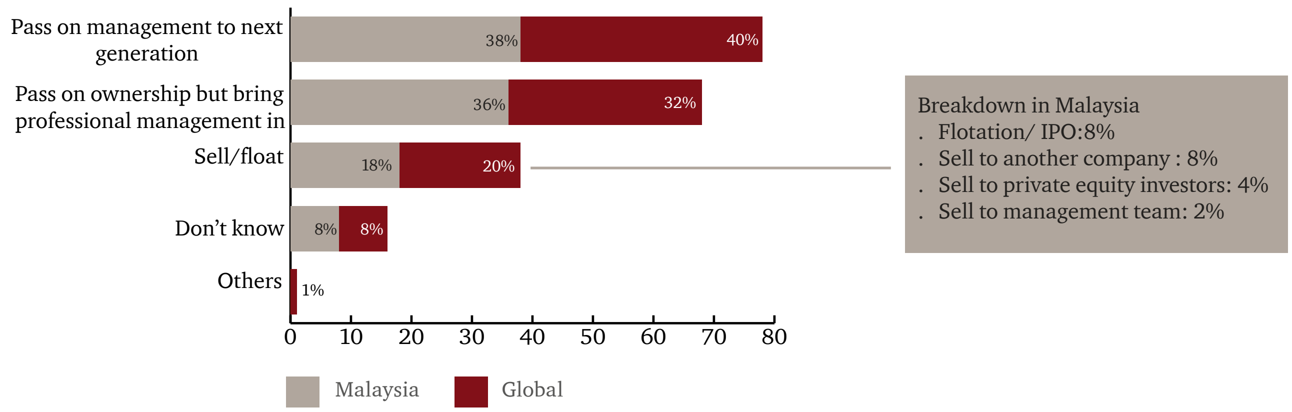
So to sum up, here is Peter's advice to family firms:

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

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

Understanding the difference between ownership and management is becoming more important, because owning-only is a trend that appears to be gaining momentum: the number of global family firms looking to pass on ownership, but not management, to the next generation is up to 32% this year, from 25% in 2012. And as the chart below shows, a slightly higher number of Malaysian firms are looking to do this:

Future Plans



Across the world, PwC has worked with a number of forward-thinking family firm CEOs who are open-minded about the next generation's involvement, because they see the family business as meritocratic, not dynastic. They would be happy to see the next generation take over, but they accept that management may skip one or even two generations, and that the firm may not revert to family management at all. However, there are other family firm members who believe they are entitled to manage the business if they choose to do so. But if there is a birthright in the family business, it's the right to ownership alone. Ownership is not an easy option, however; it has to be undertaken as an active choice, in the knowledge that it will require new skills and may even entail specific training.

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

This can also be an issue when there are some family members working in the business, and a number who do not, but still own shares. When the business is in a steady state they are usually prepared to let the managers run it, but they can become more vocal if major decisions have to be made, or a crisis develops. This is why it's important to have proper family governance processes in place to deal with such eventualities.

This should include mechanisms to deal with any deadlock in shareholder voting, the flexibility to bring in professionals as managers, and agreement on the experience and qualifications family members need to have to work in the firm.

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

Head and heart: The changing role of the family office

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

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

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

Conclusion

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

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

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

Appendix

Definitions

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

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

Survey methodology

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

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