

# *The missing middle: Bridging the strategy gap in US family firms*

US Family business survey

*How can family firms  
translate entrepreneurial  
vision into long-term  
success? By getting better at  
medium-term strategy.*



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## ***About the survey***

This report reflects the US findings from PwC's eighth family business survey, which is conducted every two years, dating back to 2002. Our latest US report highlights family businesses' views on a variety of issues, as told to us by 160 key decision-makers at companies across a range of industries. Interviews were conducted via phone and online by the independent agency Research from May 9 through August 19, 2016. The US findings represent one component of PwC's global survey of over 2,800 companies across 50 countries.

For purposes of this survey, a family business is defined as one in which (1) the majority of votes are held by the person who established or acquired the company (or by their spouses, parents, child, or child's direct heirs) and (2) at least one representative of the family is involved in the management or administration of the business.

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## *Overview*



In the decade that we've been surveying family businesses, we've talked to founders, next gens, and professional CEOs of family firms — 160 of them in this latest survey — and we've noted recurring themes. These underscore evergreen qualities that we also see in the family businesses we work with — an entrepreneurial spirit, a commitment to community, a focus on long-term strategic thinking and legacy, and, conversely, a blind spot about succession planning and the necessary good governance underlying it.

This last quality — inattention to succession planning — speaks to the overall theme of this year's survey report: the missing middle. By "missing middle," we mean the gap between two visions — the entrepreneurial vision that sparks the formation of a business and the long-term vision that allows family firms to pursue strategic goals far into the future. For a vision to become a sustainable reality, it needs to be coupled with a clear and well-executed plan that bridges the mid-zone between now and the distant horizon.

Although our survey data tells us that family firms are executing well enough for the time being (two-thirds of them said their revenue grew in the past year, and nearly all expect growth in the next several years), what about 10, 15, or 20 years from now? Less than one-quarter of the family firms we spoke with have been in business for more than three generations. And although most of the firms we talked to are doing just fine, we should point out that our survey doesn't include failed family firms — the ones no longer in business, the ones that didn't make it to the third generation, let alone the fourth.

When 87% of family firms tell us they plan to achieve their growth goals by continuing to sell the same products and services, and just 11% say they intend to diversify, it does make us wonder whether they'll still be in business a few survey cycles from now. The 42% of firms that told us they plan to start new entrepreneurial ventures look better poised for the future. But an entrepreneurial venture needs legs, and that is where good medium-term strategic planning is needed.

By strategic planning, we don't mean a plan for getting the tactical, day-to-day business accomplished, which most family firms already do well. We mean a plan that looks

beyond the next 12 months, a plan that anticipates industry disruption (not just what might happen a decade from now, but also what could happen in the next several years) and prepares for it. This includes preparing for disruption within the firm, such as the sudden need for a new leader. Which is why robust succession planning is so critical to the health of family businesses. Robust planning goes well beyond choosing a successor. It involves grooming that successor throughout the medium term — the gap between now and the eventual changing of the guard. And so succession planning should be part and parcel of strategic planning, not its own discrete thing.

In 5 years, **87%** of businesses will still earn the majority of revenues from the same products/services



Q3d: How likely is it that five years from now your business will still earn the majority of its revenue from the same products and services?

Within succession planning, there is another critical gap to bridge — the gender gap. Just 10% of our survey respondents were women. And while that's twice the number of women in C-Suite roles at Fortune 1000 and 500<sup>1</sup> companies, it's distressingly low when you consider that women not only make up half the US population, but are also more likely to hold a college degree than men are.<sup>2</sup> Family businesses are in a unique position to take a leading role in cultivating female leadership — by encouraging female family members, early on, to take an interest in the family business and to believe that they can play a vital part there. At present, 64% of family firms say that females and males in the next generation will be considered equally for leadership positions — a number we'd like to see increase the next time we conduct this survey.

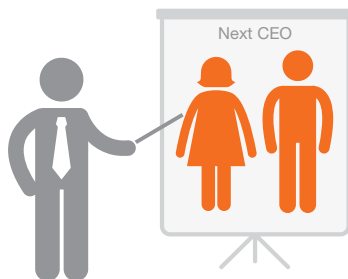
What we've seen in this latest survey, however, is that fewer family firms plan to pass the business on to the next generation, period. This is especially true of the 17% of firms that foresee an ownership change in the next five years — just 52% of them plan to keep the business in the family, versus 74% of companies who said this two years ago. We see the same downward trend among firms contemplating ownership change farther into the future (beyond five years from now) — 69% foresee ultimately keeping the business in the family, versus 79% saying this two years ago.

Even fewer firms say that the next generation will both own and run the business within the next five years (41% now vs 48% two years ago). For the most part, though, outside management won't be stepping in to fill the breach — just 11% of these companies are planning to have the next generation continue to own the business while someone else runs it. This is a marked departure from the 26% of family firms that were planning to take this route a couple of years ago. In this latest survey, far more businesses told us that, instead, they'll be seeking buyers outside the family within the next several years — nearly one-third of respondents, compared with 19% two years ago.

## Leadership opportunity: Closing the gender gap

Family firms can lead the way

**64%** of family firms say they are gender-blind in promoting leaders



What steps might they take to create **100%** equal opportunity?



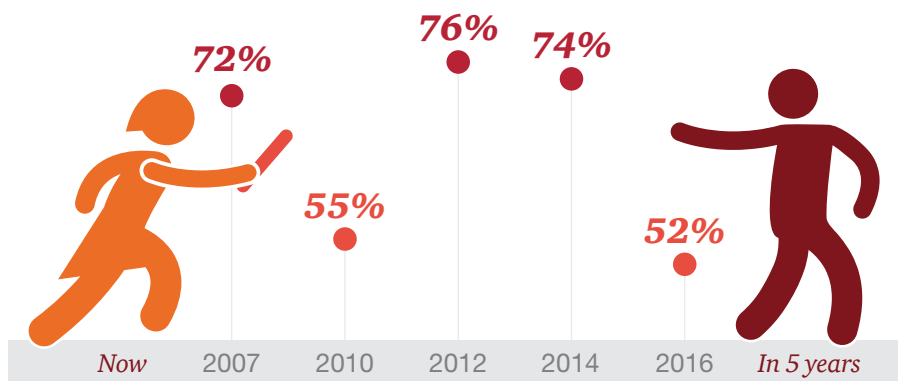
Q18c: Will female and male next gen be considered equally for leadership positions?

So does that mean family firms are growing increasingly insular? No. Although 91% of today's family firms are both owned and run by the family, only half say that successors to key senior roles will be family members (mirroring what they told us two years ago). And the majority of family firms (61%) say that over the next five years their business will also bring in experienced professional nonfamily managers to help run things. With this greater professionalization of family businesses, future surveys may show that more firms end up planning to keep things in the family, after all, reversing the shift we're seeing in this latest survey.

Greater professionalization of family businesses means making sure the middle doesn't drop out of their strategy. It means staying constantly alert to new innovations and competitive threats around the next corner and several corners beyond that, including ongoing digital disruption. Strikingly, just one-third of family businesses say they feel their business is vulnerable to the threat of digital disruption in the short to mid-term. This finding, if nothing else, underscores the need for family firms to put the "missing middle" into their strategic outlook. Doing so will help them thrive in the long term, and more crucially, allow them to survive in the near term.

## Peering into the middle distance

Passing the ownership baton to the family... or not... in the next five years



Just slightly more than half of family firms that plan to change hands in the next five years say they'll keep the business in the family — the lowest number since 2010 and a significant drop from a couple of years ago.

Percentages reflect only those family firms that plan to change ownership in the next five years. Q15bi: What type of ownership changes are you anticipating in the next five years?



## *Growth and globalization*





Nearly all the family businesses we spoke with for this survey told us that they expect revenue growth over the next five years. How will they achieve this? Most of them (87%) plan to keep doing what they're already good at — which is fine, if they also plan to diversify; but they don't. Just 11% say this is an important goal in the medium term. And although 29% think it's likely they'll sell goods and services in new countries within the next five years, only a meager 4% say this is an important priority. More encouragingly, 42% think they'll establish new entrepreneurial ventures in the next five years, which could make them better poised for sustained growth than companies that plan to just stick with what they know best.

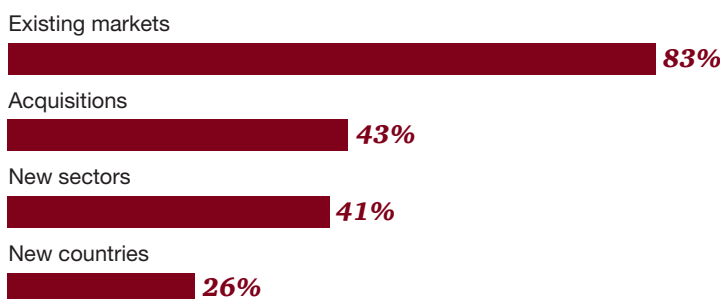
Family businesses that expect double-digit growth in the next five years have a greater appetite for diversification, with 41% of them saying they'll achieve that growth by expanding into new industry sectors. Another quarter of them plan to expand into new countries, and 43% are eyeing acquisitions. But like most family firms, these fast-growth companies are betting most heavily on their core business and current market, which could make them particularly vulnerable to competitive threats.

As for the one-third of family firms that have yet to diversify at all, let alone have plans for future diversification, the question to ask themselves might not be whether they want to continue growing steadily and comfortably, but rather, whether they want to exist five or ten years from now. In a world where industry disruption is the norm, not an anomaly, this question is one to take seriously.

## Growth expectations

Key ways family businesses plan to achieve 10%+ growth in the next five years

### Grow core business in:



Q3e: Which areas do you think will play a big role in driving your 10%+ growth in the next five years?

## Generational lens: Short-sighted approach to taking the long view

A company's long-term survival often depends on diversifying into different businesses and moving into new regional markets at home. But neither set of family business generations — 1st/2nd gen or 3rd+ gen — ranks these as high priorities. Much more important to these companies is improving their profitability.

### Family firms' priorities based on their generation

This priority mix runs contrary to the truism that family businesses are willing to take the long view by putting patient capital to work (e.g., in diversification and market expansion) and wait for ROI. To get the job done, patient capital has to work in the medium term. Without medium-term thinking, the middle will fall out of a family business's long-term strategy.



Q3ba: Which personal and business goals are very important to you over the next five years?

## International expansion

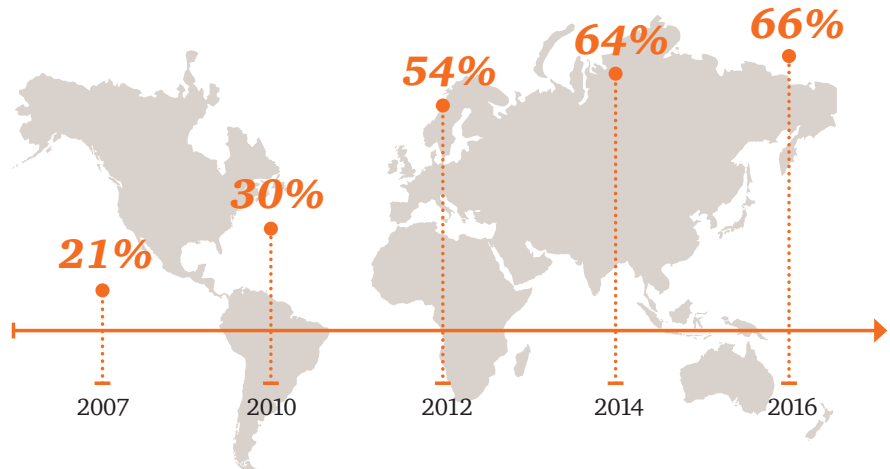
Nearly 60% of US family businesses export their goods or services, and 66% say that this will be the case five years from now. Family firms predict that foreign sales will contribute 14% to their sales overall in five years' time, up from the current 11% contribution. When we surveyed family firms in 2012, sales abroad contributed 7% to overall revenue and they predicted that would rise to 10% by 2017, so they've exceeded expectations. But is this something to applaud, considering how relatively low expectations were to start with?

Foreign sales as an overall percentage of revenue is certainly lower than what we at PwC see among private-company exporters in general (as opposed to family businesses specifically), which on average generate 20% of their overall revenue from sales abroad and predict faster revenue-growth rates than their domestic-only peers.<sup>3</sup>

So what can family firms do to reap more from foreign markets? Well, often it's a matter of learning-by-doing. And sometimes how much learning you can do depends on how many mistakes you can literally afford to make. A key way to avoid costly mistakes is to understand that a one-size-fits-all approach to entering different foreign markets won't work. Consumer tastes, distribution networks, and regulatory requirements and a host of other factors can vary widely within just within one country, let alone across a region. If you are unable to hire in-house expertise to help navigate these complexities, it's a good idea to seek outside advice, including from industry peers who've already had a chance to make exporter mistakes and learn profitably from them.

### Broadening horizons

The percentage of US family businesses planning to sell abroad has risen steadily over the past decade.



Q4b: Approximately what percentage of your sales do you think will come from exporting or selling goods/services to foreign countries in five years' time?

# Amy's Kitchen

**A homemade success story broadens its horizons: Amy's Kitchen furthers its organic growth through diversification and globalization**

It would be hard to find a better example of what a family firm can achieve than Amy's Kitchen. In 30 years, Rachel and Andy Berliner have gone from making food in a small kitchen to fund their daughter's college fees, to owning and managing a multimillion-dollar organic food business that's so successful it doesn't even need to advertise.

It's a business that began with passion and principles, and those two things still inspire it today. "It started when I was cooking for Rachel while she was pregnant with Amy," says Andy. "We were passionate about organic food, and I didn't have the time to cook things from scratch, so I just wanted to buy good-quality convenience food. But I couldn't find it — not even in the health-food store. And we said to ourselves, there must be people like us out there who want the same as we do. People who'd buy home-made organic and natural ready-meals that actually tasted great. So we made one product, just to test it out. It was a vegetable pot pie. That's where it all started — with a vegetable pot pie."

Within a few months, that pot pie was being stocked in health-food stores across the US. "Our hunch about the potential demand was absolutely right," says Andy. "The business just grew from there. We were growing over 20% a year for the first 20 years."

Thirty years on, Amy is grown up and the business has grown up, too: The company now has more than 230 products and 2,500 staff, multiple production facilities across the US, and a new prospective plant in Portugal to serve the company's growing export business. Still, Andy admits that "it's harder to grow as fast as we did in the beginning, because so many other operators have moved into the same space." The key to their ongoing success, says Rachel, is that "we've always known that to be a vital, growing company, we need to diversify by coming up with new ideas and products. We don't want to come out with something that's already existing."

International cuisine has been one route to diversification; international expansion has been another. The company



Rachel, Amy, and Andy Berliner



already has a presence in Europe, with particular success in the UK. "We have products based on a whole range of international cuisines, made from authentic ingredients by people who grew up eating and loving that food," says Andy. The next big prospect is India. It's a huge opportunity, and one completely different from that in either the US or UK, but it's ideally suited to the brand, given the growing middle class and the large proportion of vegetarian consumers. Other companies might find the sheer complexity of the Indian market daunting, but Amy's Kitchen has always had both the courage and the confidence to back innovative ideas.

Their new drive-thru restaurant is a great example. As Andy explains, "We were always being contacted by people saying that there was nowhere healthy to take their kids — people who weren't necessarily vegetarian but didn't want to feed their children fast food. So we opened an Amy's, just as a pilot, and it's been amazing. Sales are twice what we hoped, and it's generated this incredible following on social media. We didn't even set the site up — it was started by people who ate there and loved it. That's what the brand has always been about.

But, as Andy is quick to point out, "Although we're a big business now, we're still just a back kitchen at heart. A much bigger kitchen, with much bigger pots. But we care about what we make and how we make it, and people can tell. You just can't fake that."

## *Innovation and digital disruption*





Two-thirds of family firms say that the need to continually innovate will be a challenge over the next five years. Nearly just as many think that family businesses are more entrepreneurial than other types of companies. Entrepreneurship and innovation often go hand-in-hand (think start-ups); therefore, having a strong entrepreneurial knack should help family firms meet the innovation challenge. So, too, should the fact that over half of family firms think that they reinvent themselves with each generation — but do they, really?

If the answer is yes, then why are most family businesses focused on selling the same goods and services instead of diversifying? It's telling, perhaps, that one-third of family businesses worry that having family members in key positions can make the company less open to new thinking and ideas — i.e., less likely to reinvent themselves with each generation. Certainly, selling the same goods and services doesn't set a company up well for reinvention. It bodes well, then, that nearly two-thirds of family firms say that they plan to hire experienced, professional nonfamily managers to help run the company within the next five years — people who, ideally, will invigorate the business with new ideas. Though, this may take some effort. "It can be a challenge to get the family business to be innovative, thinking outside the box, getting them to open up the lid," we were told by a nonfamily-member CFO at a 1st gen company.

At present, just 21% of family firms rank "being more innovative" as a very important business goal. Compare this with the 67% of firms that prioritize "ensuring the long-term future of the business." This disconnect is a prime

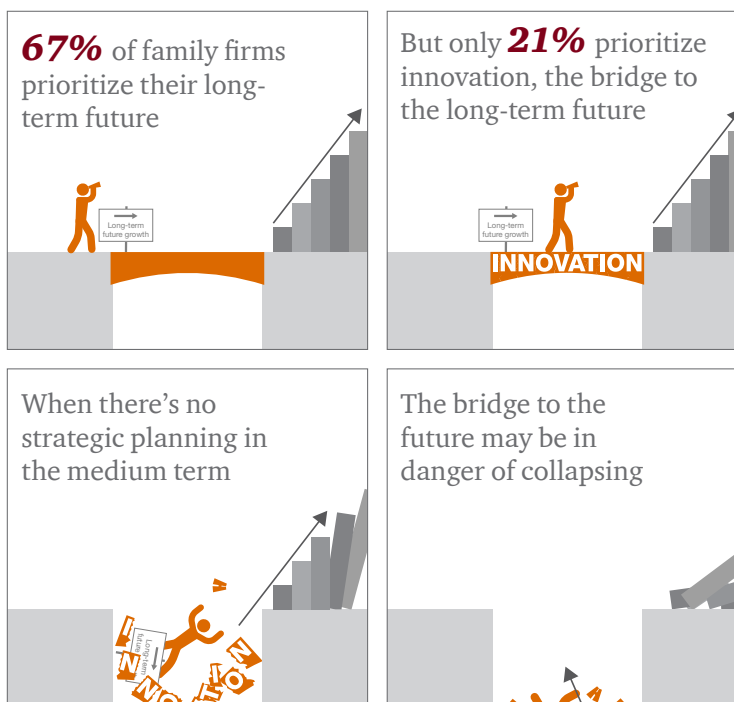
example of the missing middle: Without innovation, now and in the medium term, a firm is unlikely to successfully bridge the gap between the current moment and the long-term future.

To do innovation well, a business needs to think beyond the immediate demands of the day to day and make judgments about what the picture might look like two, five, or ten years out — what trends are driving change and affecting the market, what products could be vulnerable to new technology, what dark-horse competitor might emerge around the next corner?

"Disruption in the medical-device industry is always a potential threat on the horizon," says VP and CFO Steve Ragaller of his employer Cretex Companies, Inc., a manufacturing business serving the medical, infrastructure, industrial, and aerospace & defense markets. The firm is about to celebrate its centennial anniversary — a milestone you don't reach through short-sightedness. "They take a long-term view," says Ragaller of the owners, "because it is their intent to keep the family business."

### The missing middle

Has innovation fallen out of your strategic planning?



Q3b2: Which of the following potential goals would you rank as very important?

## Digital disconnect

More evidence of the missing middle is the fact that just half of family firms say they understand the tangible business benefits of moving to digital and have a realistic plan for measuring them. Even fewer family firms (32%) feel that their business is vulnerable to the threat of digital disruption in the short to mid-term, and almost just as few (34%) think cyberthreats will be a challenge. Meanwhile, less than half of family businesses say they're prepared to deal with a cyberattack. This "hear no evil, see no evil" MO does not lend itself to strategic planning and exposes companies to significant risk.

Indeed less than half (45%) of family firms say they have a strategy fit for the digital age. Without such a plan, keeping pace with digital and new technology is likely to be difficult, and not just for the 41% of family businesses that admit this is a challenge. The consequences? Family businesses could be blindsided by industry disruptors and more digitally savvy competitors — an unenviable position for any company.



## Generational lens: Digital divide

Family firms put themselves at risk by turning a blind eye to the short- and mid-term threat of digital disruption. This blind spot is shared by older and younger companies alike.

Where we see a generational divide is in how well family firms think the threat is understood by their boards. Just one-third of younger companies (1st/2nd gen) that feel vulnerable to digital disruption think their boards fully comprehend the threat, whereas over half of mature family firms (3rd+ gen) think their boards are alert to the problem.

When it comes to understanding the tangible benefits of digital technology, knowing how to measure them, having a strategy fit for the digital age, and being prepared for a cyberattack, both older and younger firms are in similar agreement about how well they're doing in these areas. However, 1st/2nd gen businesses feel more strongly about their success here than 3rd+ gen firms.

***“Technology is so critical and expensive that we rely on the next generation to mediate with our board members, which is a challenge as it creates a two-tier board.”***

**Nonfamily CEO,  
4th gen Texas wholesaler**



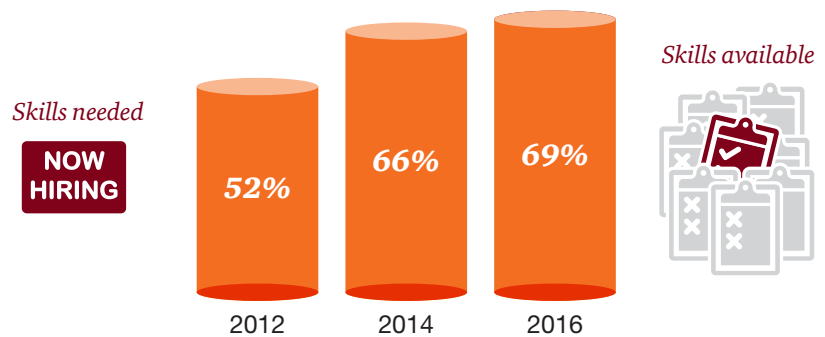
## Skills gap

To innovate effectively, businesses need to have the right talent on board. Nearly 70% of family firms say that attracting and retaining the right talent will be a challenge over the next five years, and 44% say they think family firms need to work harder at this than other types of businesses. Part of this surely stems from the fact that outside talent may have less opportunity — or think there's less opportunity — at family businesses. Family members may appear more likely to take the choicest roles on the management team and be better poised for top leadership positions. Although two-thirds of family firms insist that next-gen family members have to work even harder to prove themselves to the company, just 42% of those firms go so far as to say that the next generation hasn't been given any preferential treatment.

Next-gen women might be the least likely to argue this last point, at least where their own career opportunities are concerned. Just 10% of the family business leaders we surveyed were women. And yet, offering more women leadership roles at family businesses could deliver significant economic benefits, not only to the firm's themselves, but also to overall GDP growth.<sup>4</sup> Right now, however, less than half of family firms have an active gender equality program. An increase in the number of these programs could lead to a decrease in the skills gap that family businesses keep trying to close.

## Mind the widening skills gap

Over two-thirds of family businesses worry about filling the skills gap in several years, up from roughly half who voiced this concern back in 2012.



Q12b: Currently, how many next generation family members are there (if any) that are senior executives within the company or work in the company but are not senior executives?

## Generational lens: Talent pipeline

Attracting and retaining the right talent is harder for older family firms (74%) than for 1st/2nd gen businesses (65%).

With multiple generations, there tend to be more family members working in the firm and taking the plum spots, leaving fewer career paths and potential leadership positions open to outsiders who might join the firm. Nearly two-thirds of firms that are three generations or older say they have family members serving as senior executives, whereas less than half of 1st/2nd gen firms say this.

Younger companies (1st/2nd gen) are less inclined than mature firms to think that next-gen family members are being properly appraised — just half of younger companies think so, versus two-thirds of companies that are three generations or older.

More encouragingly, three in four younger companies think that men and women in the next generation will be considered equally for leadership positions. Not so of companies three generations or older — just slightly more than half of them say they'll give men and women an equal shot at top roles.

# *Succession*



***“It’s important to provide different family members who have varying levels of education, experience, and knowledge with needed understanding and insight about the family’s business in order to build and maintain the trust required to sustain the company’s long-term vision.”***

Financial director,  
4th+ gen Illinois conglomerate business

Succession planning is a perennial problem for family businesses. We see this in every survey cycle and at many of the family businesses we work with. Nearly 44% of those we surveyed this time say that succession planning will be a challenge over the next five years, and just 23% have a robust, documented succession plan in place (even fewer than two years ago, when 27% had such a plan).

Why? Well, in large part, because many family business leaders (46%) say they are reluctant to pass the baton to the next generation.

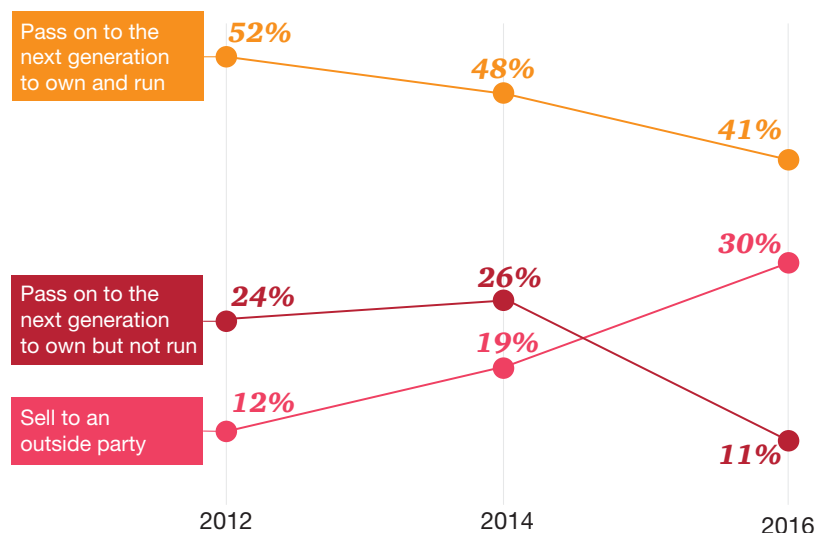
Just slightly more than half of family firms that plan to change hands in the next five years say they’ll keep the business in the family — the lowest since 2010, back when family firms and family wealth were still reeling from the recession. This time, pre-election uncertainty and renewed economic jitters served as the backdrop for the survey, and so we may see this data point swing back up when we survey family businesses again in 2018. But family businesses are also growing increasingly complex, reflective of the business landscape overall. This complexity may be making the family enterprise more of a headache for its owners than a rewarding challenge. As a result, the recent dip in the number of firms planning to keep things in the family could be the start of a trend rather than just a blip on the screen.

One solution to working through complexity is to enlist outside professionals to help run the business. Nearly two-thirds of family firms overall say they indeed plan to do this. But of the 17% of family

### **Maintain total control or sell outright**

That’s what it boils down to for most family firms planning ownership changes in the next five years — a marked shift from the prior two surveys.

#### **Form of expected ownership change in next five years**



Twelve, seven, and eighteen percent of firms answered "don't know" or "other" in 2012, 2014, and 2016, respectively. Q15bi: What type of ownership changes are you anticipating in the next five years?

firms that plan to change ownership in the next five years, few intend to bring in outside professionals to manage the business, opting to either have the family remain firmly at the helm or else simply sell outright. This is a big departure from a couple of years ago, when we last conducted our survey.

Part of family firms’ reluctance to enlist the help of outsiders may stem from their concern about whether the family’s vision

for the business will be truly understood and honored. “We’re forming an advisory board, but finding people who share our values and have the right experience to help is not easy,” says Andy Berliner of Amy’s Kitchen. “We want people who not only have the skills, but who also appreciate what we’re doing and can put their heart into this.”

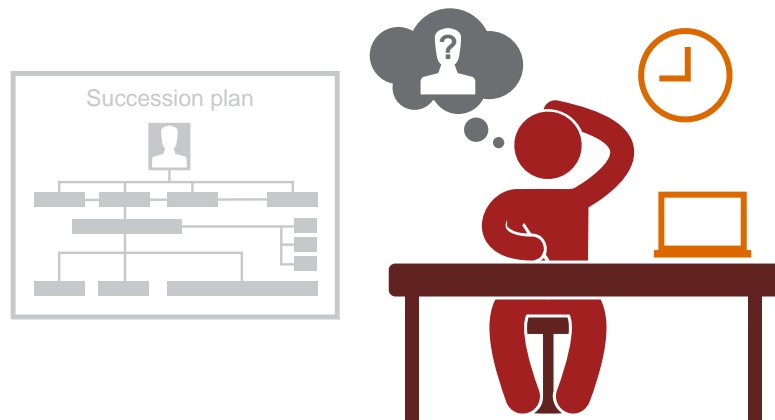
If family firms have little appetite for either selling their business or bringing in outsiders to help run it, they'll need to train family members to take greater responsibility. But again, this involves relinquishing control by the current leaders so that decisions can be delegated to eventual successors, allowing those individuals to learn by doing.

First, however, a successor (or successors) must be chosen. And that requires planning. But nearly one-third of family firms have no succession plan at all, and even fewer have a plan that's actually been put in writing and communicated to key stakeholders — just 23% of family firms have a robust, documented plan.

These numbers are worrisome. That's because lack of a formal succession plan can lead to a number of problems when the current owner ceases to maintain control. The next generation may be reluctant, unprepared, or unable to assume the current leader's level of responsibility. Then again, the owner might identify a willing successor but find that family members and other key stakeholders do not support the decision. The business owner could also discover that keeping things in the family simply isn't practical (e.g., there isn't enough liquidity to support a family buyout from the generation that currently owns the business). Although such issues can be difficult to confront — and therefore tempting to put off — it is better to deal with them now rather than at the last minute, when options may be more limited.

And once a plan has been put into place, it shouldn't be treated as a one-time event. Good succession planning involves a series of intentional, well-coordinated, strategic efforts, sustained over time — in essence, bridging the middle. It is in the medium term that the successor will thoroughly train for his or her eventual role as the long-term steward of the company.

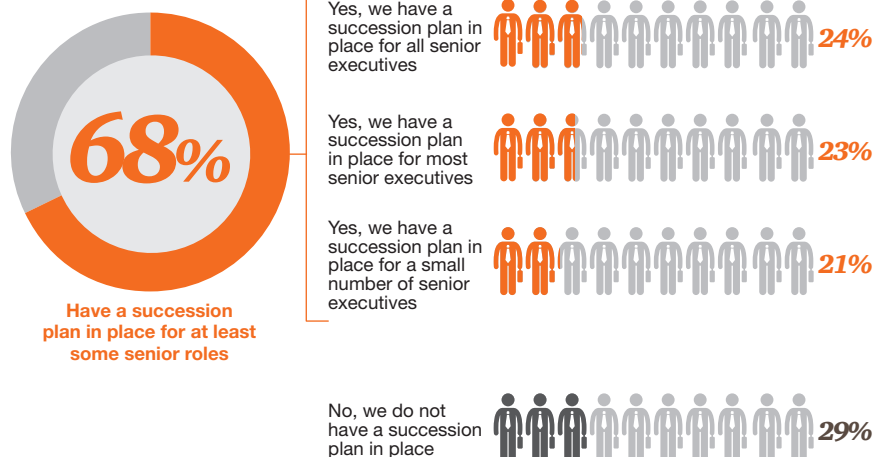
Succession is a breaking point for many family firms, but only **23%** of them have a formal plan in place.



Q14b: Is your succession plan robust, documented and communicated, or is it less formal than that?

### Succession plan for senior roles

Two-thirds of family firms have some kind of plan, even if just an informal one



Q14a: Does your company have a succession plan for key senior roles? 3% responded "I don't know/other"

# Mitzi Perdue

## Bridging the gender gap, entrepreneur-style

Just 64% of US family firms say that women and men in the next generation will be considered equally for leadership positions, compared with 75% of family firms globally. This is despite the fact that women in leadership roles makes economic sense for businesses, correlating with better financial results and all-around performance, as shown by numerous studies.<sup>5</sup>

While it is dispiriting to see US family businesses lag behind their global counterparts in gender equality, women have nonetheless made significant strides in the US workplace over recent decades. This is thanks in no small part to the examples set by intrepid female entrepreneurs like Mitzi Perdue.

The daughter of Ernest Henderson, founder of Sheraton Hotels, Mitzi Perdue clearly has entrepreneurship in her blood. But back in the 1940s, when Mitzi was a girl, a successful entrepreneur looked like the last thing she was likely to become. “My father made it pretty clear that I was never going to be in the family firm. I don’t think it even crossed his mind that one of his daughters would have an interest in the business. And it wasn’t just that nobody expected me to do it, it was actively discouraged.”

It was the moment of transition between the generations that opened up an opportunity for Mitzi — when her father died in 1968. She still didn’t get the chance to work in the hotel business, but she did inherit enough money to start up a venture of her own. “The Henderson family decided to sell Sheraton, but it was only the men who got to have a vote.



The women had just as strong views, and we were stockholders, but we didn’t get a say. Soon after that I started a business growing rice in California, and I think I must have learned a lot from my father about the importance of picking the right site, because I deliberately chose an area where I thought the land might have future development potential.” The site was indeed eventually sold for an enormous profit, but in the meantime Mitzi spent 15 years growing a profitable rice business, and had a great deal of fun as one of only eight women out of the five thousand rice growers in the US: “The other seven inherited their firms. I made mine.”

Mitzi learned the value of visibility as a woman in a male-dominated sector and became a leading light in the industry, playing an instrumental role in preventing legislation that would have decimated rice growing in the area and serving as president of American Agri-Women, a 35,000-member organization. She puts her success down to a willingness to do her homework and work hard. Not being afraid of failure is important too. In fact, she says she “failed her way to success.”



## *Strategic planning*





Greater emphasis on strategic and medium-term planning is the missing piece that would allow many family firms to achieve greater success and longevity. Some family firms are doing this already, and doing it well, but others are caught between everyday concerns and the weight of inter-generational expectations.

Plenty of family businesses do have plans covering specific issues, such as technology, but often they have no overall strategy linking these individual plans together. Ideally, such a strategy would be devised and then laid out in one clear plan covering all aspects of the business and explicitly aligned to the family's long-term objectives. The good news is that nearly 70% of our survey respondents say that the strategy of the family and the strategy of the business, such as it is, are completely aligned. If this is indeed the case, those businesses have a very solid platform for strategic planning.

What we often see, however, is that the owner has a plan in his or her head but doesn't share it. In the long term, this can be a recipe for failure, making it hard to attract professional managers or obtain external funding for financing growth or restructuring. There needs to be a clear plan, written down, and communicated, and it needs to start with an agreed-upon vision and values.

Perhaps this lack of strategic planning — and hence inattention to the missing middle — reflects the fact that more family firms are now contemplating a sale to nonfamily buyers in the next five years, a decided uptick from when we last conducted our survey in 2016. This is particularly true of younger firms. Of the roughly one-fifth of family firms that are contemplating a sale in the next five years,

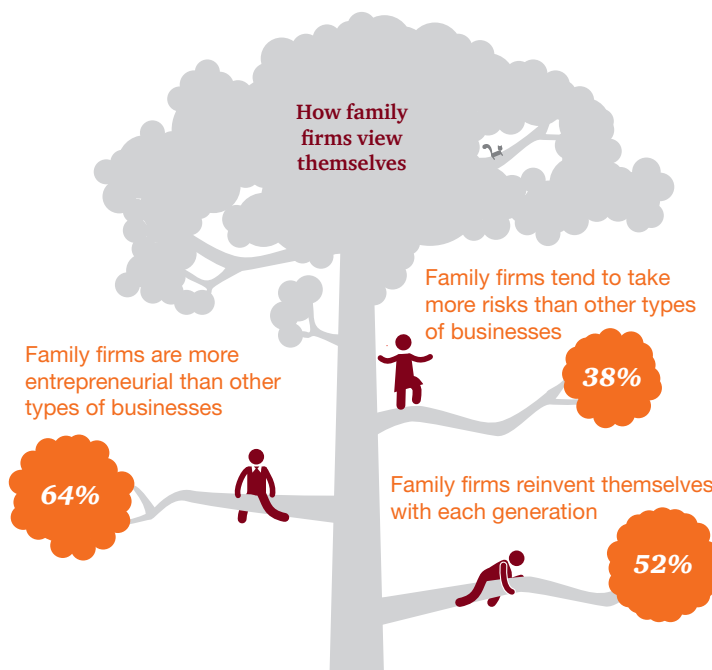
strikingly more 1st/2nd gen businesses are inclined to sell outside the family (50%), compared with older firms (8%).

The majority of family firms, however, don't plan to sell their business in the next five years. So it's good to hear that the majority of family firms also think they reinvent themselves with each new generation. Older firms (3rd+ gen) think this more so than younger ones, perhaps, in part, because older firms have had more time to test this notion. Conversely, more 1st/2nd gen firms consider themselves entrepreneurial, a key ingredient to reinvention.

Certainly an entrepreneurial mindset is a good one to have if you want to sustain a business for the long term. But to be entrepreneurial requires taking risks, and only about one-third of family businesses overall think they take more risks than other types of businesses. Again, here are signs of the missing middle — without taking risks in the medium term, companies cannot effectively bridge the gap between entrepreneurial vision and a long-term future.

## Risking reinvention

Are enough family businesses willing to go out on that limb?



Q8: Do you agree that family businesses reinvent themselves with each new generation?  
Q9: Do you agree that family businesses differ from nonfamily businesses in that they are more entrepreneurial and tend to take more risks?

And, as the family continues to grow with each generation, along with the business, dividends tend to become more thinly spread. This can make family shareholders reluctant to reinvest some of those dividends into the growth of the business, potentially putting the firm's longevity at risk.

As an independent board member at a 4th gen Texan wholesale firm with \$1 billion+ in annual revenue bluntly

put it, "The family is risk averse. As they've evolved, the next generation is not capable of running the business." His sentiments were echoed by another outside executive, this one at a 7th gen manufacturing firm in Louisiana: "The challenge is that the family ends up being the ultimate decision maker and can lack willingness to take measured business risks in some cases, even when it could open the door to opportunities."

## Peering at the horizon

### Generational lens

Young and old firms alike have their eyes on the long-term future, but not necessarily one where their business stays in the family

### Family firms' perspective

The business's long-term future is an important goal



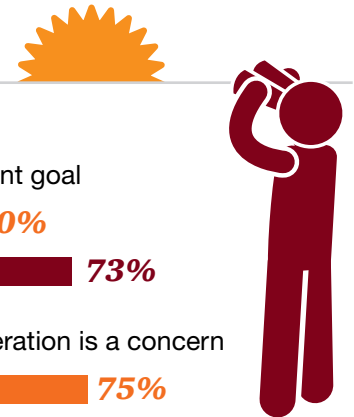
Ensuring a smooth transition to the next generation is a concern



Keeping the business in the family is an important goal



Q3ba: Which personal and business goals are very important to you over the next five years?  
Q18c: Will you stay involved in the business to ensure a smooth transition to the next generation?



## Ten steps to effective strategic planning

For family businesses that do want to keep things in the family, here are 10 steps to planning strategically over the medium term so that the business stays in business for the long term:

- 1. Focus on goals, not tactics:** A strategic plan should not be confused with a business plan. A strategic plan is about setting your business goals over the medium term and deciding the direction of the firm, whereas a business plan lays out specific actions a company must take in the next year to make the strategic plan a reality. Although having a good business plan is crucial, it's only part of the answer.
- 2. Stand in the future and look back:** Where do you want to be in three years? In five? In a decade? Be absolutely clear about what you want the future to look like, and then decide what you need to do to get there, including the changes you'll need to make to your products and services, balance sheet, working culture, and your organizational structure, to name just several areas.
- 3. Stand in the present and look around:** Take a long, hard look at the business as it is right now. Do you have a genuine competitive advantage? Are your ambitions realistic? What needs to change? Ask yourself whether you're adequately assessing the threat of new competitors and the likelihood of new game-changing products or services.
- 4. Invite input:** Although the CEO needs to drive the strategic plan, the more people who contribute to it, the more robust it's likely to be. People are also more committed to something they've helped create. So involve skilled people from across the company, and enlist trusted outside advisers, including those with a good grasp of how the market is changing.
- 5. Be prepared for change:** A rigorous strategic planning process should challenge the way you're operating today and test its fitness for the next phase. If it doesn't do that, it's not doing its job. So be open to different alternatives and approaches, accepting that you might need to adapt your own personal role, as well as the way the business operates.
- 6. Set a timescale:** A good strategic plan is like an itinerary — it's about when you plan to reach the milestones along the way, as well as the final destination.
- 7. Assign responsibilities:** The CEO and board must take ultimate ownership of the plan, but specific elements need to be owned and driven by appropriate managers and supported by the budget and resources necessary for success.
- 8. Translate the strategic plan into a business plan:** Move from the strategic to the tactical by turning the first phase of the plan into a program of action and implementation over the next 12 months.
- 9. Measure, monitor, and adapt:** As you implement the plan, assess how well it's working and whether it needs to be fine-tuned. Use objective key performance indicators to evaluate progress.
- 10. Communicate, communicate, communicate:** Don't just share the strategic plan, but also communicate the progress you're making against it. This builds a shared sense of commitment, energy, and sense of direction.

## *Professionalization 2.0*



Every firm eventually reaches a point when it has to professionalize the way it operates. How? By instituting more rigorous processes, establishing clear governance, and recruiting skills from outside. Family firms are no exception.

But the family firm has another dimension that other companies don't have to tackle: the family itself, and the truism that family firms fail for family reasons.

"Understanding the family dynamic is not always apparent, because that dialogue takes place in a family setting," acknowledges the owner of a 2nd gen manufacturing business in Ohio with over \$1 billion in annual revenue. "It can be hard to separate the family needs and conflicts from the needs and goals of the business, but it's important that this be done."

Bringing in external managers can be very helpful in this regard. We're encouraged to see that this is being planned by 61% of the family firms we surveyed. It takes on added importance and urgency in the context of the "missing middle." Indeed, many family firms already have enlisted outsiders to help run the business — nearly half the participants in this year's survey were nonfamily members.

One of the crucial roles a nonfamily executive can play is to sound an objective voice of reason when family emotions run high. "The culture of a typical family business is problematic in that decisions are not necessarily rational or analytically driven," says a nonfamily executive at a 2nd gen manufacturer in New York.

Our latest survey shows that family firms recognize this about themselves. Not only are they continuing to establish processes to professionalize the business, but they're also looking to "professionalize the family." They're doing this by instituting mechanisms such as shareholders agreements, family councils, and incapacity arrangements. Many family firms are also using a family office, which can help them with a variety of matters, including professionalizing how non-employee family members interact with the business.

Despite family firms' increasing focus on professionalizing their businesses, nearly 40% of them say this will continue to pose a challenge (just about half as many said this two years ago). How well family businesses meet it can affect how successfully they're able to recruit and retain outside talent. It requires taking a clear-eyed view when appraising next-generation family members against outsiders for roles and promotions in the company.

Just 21% of family firms think they do a good job of that. And while two-thirds say that next-gen family members have to work even harder than other employees to prove themselves to the company, one-third admit that next-gen family members have received preferential treatment because they are family members. That treatment may account for the jump in the number of family businesses employing next-gen family members — 74% of family firms in this latest survey told us they employ next-gen family, up from the 59% reporting this two years ago.

***"As a nonfamily member, you have a more objective view — you are not as concerned about how the business impacts you and your relatives."***

CFO, George S. Warren  
Marsh Associates, Inc.  
3rd gen company

***"We have a very well-functioning family council that interfaces effectively with the board. There is very little family involvement."***

Nonfamily executive,  
3rd gen California  
agricultural business

“It is sometimes hard to have the ability to attract world class talent, as sometimes family-run businesses are perceived as being unprofessional,” we were told by a nonfamily member at a 4th gen business with over \$1 billion in annual revenue. However, that same survey respondent says the company has “a strong governance in the form of the board of directors” — a critical way that family firms can help counter the impression they’re less professional than other types of companies.

Indeed, governance is a key tenet of professionalization, and boards have an important role to play in that regard, particularly independent boards. Encouragingly, two-thirds of US family businesses say they have nonfamily members on their board, and we see little difference here when we look at the two generational sets (1st/2nd gen companies and 3rd+ gen firms). It is instructive, though, to cast a glance at the global survey results, which include responses by firms that have been in business for centuries. Fully three-quarters of companies four generations or older (in the global survey population) have nonfamily members on their boards.

Governance at family firms could also benefit from adding more women to their boards, or including them to begin with. Research shows that companies with more women in leadership roles generally have a greater focus on corporate governance.<sup>6</sup> Most corporate boards, however, have relatively scant female membership — 17% female directors versus 83% male, as shown in PwC’s 2016 *Annual Corporate Directors Survey*. (At S&P 500 companies, female board representation is a bit higher, at 20%.<sup>7</sup>) When asked what the optimal female representation on boards should be, one in ten directors said it should be 20% or less (97% of those who believe this are male).<sup>8</sup>

## Next gen rising

With the rising number of family firms employing next-gen family members, professionalization of these businesses grows increasingly important.

**2016**



**74%** of family firms employing next-gen family members

**2014**



**59%** of family firms employing next-gen family members

Q12b: Currently, how many next-generation family members are there (if any) that are senior executives within the company or work in the company but are not senior executives?

## Generational lens: Talent pipeline

Older family firms — those in business for three generations or longer — are more likely than younger firms to think that the next generation is being properly appraised — 65% versus 51%.

Encouragingly, many younger companies think that men and women in the next generation will be considered equally for leadership positions — three-quarters of 1st/2nd gen companies say this. Not so of companies three generations or older; just slightly more than half of them say they’ll give men and women an equal shot at top roles. Hopefully, as more of these younger companies mature, the women who take top roles there will set a precedent for the women in the generations coming up behind them.



## Justin Craig

**Business is personal at family firms, making professionalization critical but tricky**

“Data is data, not wisdom or knowledge,” observes Justin Craig, co-director of the Center for Family Enterprises at Northwestern University’s Kellogg School of Management. At PwC, we know this full well. That’s why we draw on our extensive work with family firms when analyzing our biennial Family Business Survey findings. It’s also why we team with academic partners like Kellogg, especially in examining perennial challenges for family businesses — ones that we see come up again and again among our clients and in our survey. Chief among these challenges are family dynamics, succession planning, and next-gen expectations.

How soon should succession planning take place? “Yesterday,” says Craig. “This is a hard conversation to have, but family enterprises need to keep chipping away at it. An independent board can help with the planning by taking the emotion and uncertainty out of the process and making key stakeholders feel that they are in good hands.”

Craig cautions, however, that “it’s important to work on the family system, not just the business system. Although conflict is inevitable nor always bad, I have seen situations where the business needs to be protected from the family, due to ongoing internal conflict. The family needs to ask itself, *Why are we in business? What is our vision as owners? What are the options?* A good governance plan can be put in place to address these questions and resolve conflicts. But in some cases, families simply are not meant to work together.”

It is no surprise, then, that many family businesses don’t survive for more than a few generations. Those that do tend to be mindful about how they handle family members who work in the business. “Set the protocols before you need them,” emphasizes Craig. “In the case of executive or leadership roles, don’t set a person up for failure. If they understand their responsibilities and know that they will be expected to do more than others, this will help reduce the tension.”

But not everyone gets to be CEO. “There are plenty of other roles in the family and the company as the business grows,” says Craig. “Many families are introducing human resource systems to ensure that members of the next generation are given the opportunity to be the best they can. But it’s important to stress that joining the family firm is just one among a variety of opportunities. Forcing someone into the family business usually does not end well.”



Northwestern | Kellogg

CENTER FOR FAMILY ENTERPRISES

Nonetheless, taking a role in the family firm may seem far less daunting to younger generations than in the past. Entrepreneurship is not a scary concept for Millennials,” notes Craig. “It is an accepted pathway. The startup phenomenon has made it part of their rhetoric. Ultimately, each new generation needs to conquer the business, and to continue differently — keeping the core philosophy but not the details. Maybe they’ll work smarter, not harder. I think the real enemy is entitlement, and that comes back to setting expectations, parenting, and learning the value of values.”

This sense of entitlement can have a negative effect on company morale, particularly if nonfamily employees think that family members are receiving preferential treatment. One way to avoid that is by setting performance metrics for everyone, says Craig: “It boils down to the concept of trust and trustworthiness.” This becomes increasingly important as more family firms seek outside professionals to help run their businesses. “Professionals will only join a family firm with a clear strategy and strong governance,” Craig warns. “There is competition for good talent. A nonfamily-member CEO told me he should have jumped from the public company model 20 years earlier, and that’s because the family firm he leads has family governance and best practices.”

A critical best practice is maintaining an independent board. “The board should have a minimum of three independent directors and a strong chair,” says Craig. “Work them hard. Make sure they understand the culture and values of the business and can serve as good counsel to the owners and CEO. You should also rotate them through various responsibilities, having them conduct performance reviews, oversee committees and task forces, and train the next generation.”

What about board diversity? “Boards are not as diversified as they could be,” acknowledges Craig. “Diversity of talent, above all, is the key to having an effective board. Companies should look at the skill-sets gap and work backwards from that point when filling director seats. As for greater diversity on boards, I think family firms have a better chance of achieving that than other businesses, because they have access to talented people due to their business relationships and strong ties to the community.”

In short, says Craig, “Remember that you have a responsibility to the business. It’s pretty simple to play that card, but not always easy when family relationships are at stake. Be prepared to have tough conversations. Stay strong.”

## *Making it past the second generation*



## What are longtime family businesses doing differently to keep themselves in the game?

### Growth strategy: Keep evolving or risk dissolving

Family businesses that make it past the second generation usually don't get there by accident. They get there by being strategic. We see this in key distinctions between the strategic mindset of the first- and second-generation firms we surveyed and the mindset of those that have made it to the third generation and beyond.

Younger companies tend to grow faster than mature companies by the sheer fact that they have more room to grow — twice as many young companies (1st/2nd gen) as mature firms (3rd+ gen) tell us they expect double-digit growth in the next five years. The question is, can they sustain that growth over the long term?

Sustainable growth requires having a sound strategy for the medium term. This is why we make a point of asking family businesses about their goals and plans for the next five years. When the “middle” is missing from their answers, it raises concerns about whether they'll be around for us to interview ten years from now when we mark a second decade of US participation in this survey.

What we see in the survey data is that younger companies are being much less bullish than their mature counterparts when it comes to key medium-term strategies for sustaining strong growth in the long term. Chief among critical growth strategies missing from the middle here are diversification and globalization.

### Diversification

More companies that have survived into or past the third generation operate in multiple industry sectors and countries, compared with younger companies. And they plan to keep it up — over a third of older family firms intend to diversify by entering new foreign markets in the next five years; less than a quarter of younger firms intend to do the same.

Diversification isn't just a means of surviving or catapulting forward in the near term. It's a strategy for thriving well beyond a company's second generation. This is understood by mature family businesses (3rd+ gen) that are sustaining double-digit growth — twice as many plan to expand to new countries (40% vs 19%), compared with younger, fast-growth firms, and almost half of them plan to expand to new industry sectors in the next five years (vs 39% of younger firms).

### Globalization

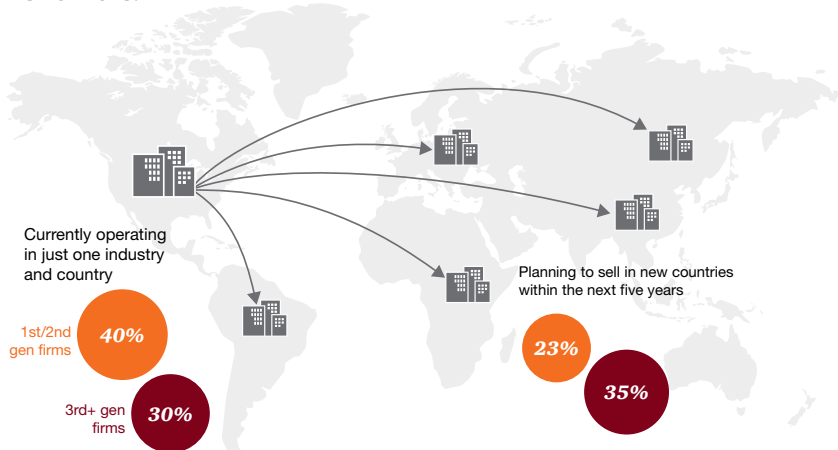
Just over half of 1st/2nd gen family firms export, deriving 8% of their overall revenue from sales abroad. In contrast, two-thirds of older family firms export, generating 13% of their income from international sales.

While both generational sets expect export revenue contribution to rise in the next five years, the younger set is prioritizing this less — 40% plan to increase exports over the next five years, compared with 54% of older companies.

Does this mean that younger companies see less market opportunity abroad than companies three generations or older? No. Both generational sets place roughly the same weight on a foreign market's growth potential when assessing export possibilities. But it's another thing to have the financial and logistical wherewithal

### The key to living long and well for family businesses? Try new things, visit new places.

The older a family business is, the more likely it makes a habit of broadening its horizons.



Q57: Which one of the following statements do you think best describes how diversified your business is?

Q3d: Thinking about the business in five years' time, realistically how likely is it that it will be selling its goods and services in new countries?

to enter new international markets — the right resources to manage regulatory complexity, distribution networks, transport costs, local workforce, etc.

More-mature companies are generally better equipped in this regard. Less than one-quarter of them say a country's language, proximity, and cultural similarity to the US are important factors in deciding where to export over the next five years, compared with one-third of younger companies saying this. Since hiring people with a broad range of the right local knowhow in foreign markets (language, tax law, etc.) can be expensive, the need to do so can be a disincentive for family firms contemplating entering new markets abroad.

Which raises the question of how family firms that are planning double-digit growth will fund it. Both generational sets plan to use their own capital (almost all of them signal this), with many of them intending to supplement it with outside financing (two-thirds of mature companies and three-quarters of younger ones). Mature companies indicate that they'll gravitate mainly toward traditional bank loans, whereas younger companies also plan to pursue debt financing, debt capital, and equity financing.

## Keys to the kingdom: Family business ownership

Over half of 1st/2nd gen companies have one dominant owner. That's considerably more than what we see at older family businesses, those lasting three generations or more. Only about one-third of them have a single dominant owner.

Although the concentration of power in one individual may prove beneficial when it comes to rapid decision-making, there's the question of whether it's resulting in the right decisions — the kind that will help the company make it to the third generation and beyond. While having one dominant owner doesn't mean that he or she will assume autocratic rule, the company does run the risk of cocooning itself from diverse perspectives that could benefit decision-making and the overall health of the company.

And then there's the leadership team, the people helping the owner(s) run the company. Here we see more of the older firms than the younger ones placing family members in senior roles. This may, in large part, be because the older the firm, the more generations have been brought up in the business and therefore know how to run it.

It's important to note, though, that nearly half of the family business leaders we surveyed (including senior executives and board directors) are not members of the presiding family. This breakdown splits almost evenly between younger companies (45% nonfamily respondents) and older ones (47%). Likewise, a near-equal number of companies in both generational sets plan to bring in experienced, professional nonfamily members to help run the business within the next five years — 59% of 1st/2nd gen companies plan this, and 63% of 3rd+ gen firms. This active recruitment of outside expertise and leadership bodes well for the longevity of young and mature companies alike.

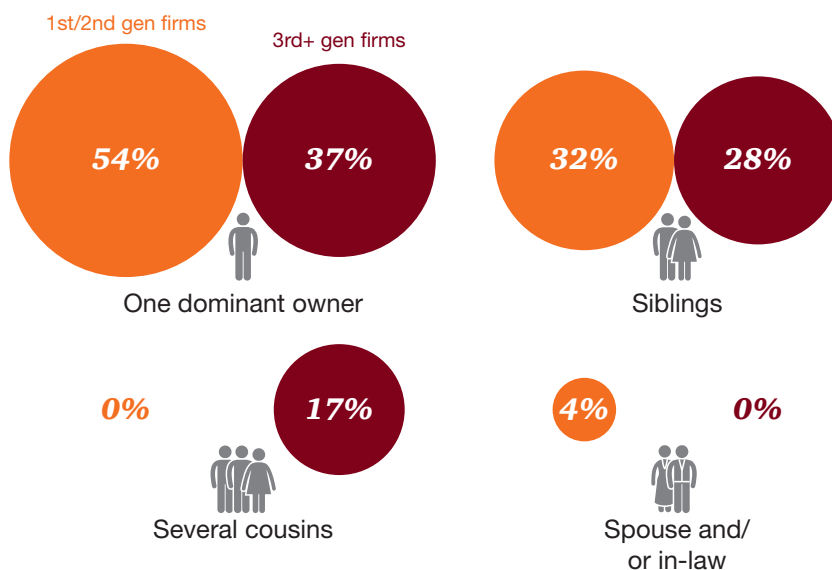
## Passing the baton: Not so easy for younger companies and their founders

Not only do the majority of family firms have outside professionals on the management team, but three-quarters of these companies also have next-gen family members working in the business. Still, that doesn't mean the current leaders feel ready to pass the baton. The younger the company, the harder it is for the leader to reckon with this eventuality. Over half (55%) of the survey participants at younger companies (1st/2nd gen) said it would be difficult to let go fully when the next generation takes over, and three-quarters intend to stay involved in the business to ensure a smooth transition.

Business founders, understandably, worry that their entrepreneurial vision and passion won't burn as brightly when they stop helping the company. The second generation may have similar reservations about the company's original spark fading when the baton passes to the third generation. This may be especially true if the second generation's formative years overlapped with the company's founding, or if the second generation actively contributed to the hands-on building of the business. Subsequent generations of company leaders, on the other hand, may have less of a "blood, sweat and tears" connection to the company and therefore be less apt to have emotional difficulty letting go. Even so, the majority of 3rd+ gen companies do say they'll stay involved in the business to ensure a smooth transition to the next generation.

## Who owns the family business?

Ownership concentration at younger and mature firms



Six percent of 1st/2nd gen and 7 percent of 3rd+ gen answered "other."

QS8: Which one of the following best describes the family ownership structure of your business?



But it's easy to put off thinking about passing the baton if it doesn't loom near in the future. Less than one-fifth of either generational set anticipate a change in ownership over the next five years. Among those that do, strikingly more of the mature firms (3rd+ gen) than the younger companies (1st/2nd gen) plan to let the next generation both own and run the business — 54% versus 29%.

One obvious reason for this disparity is that fully half of the younger companies contemplating an ownership change in the next five years plan to sell the business to outsiders, rather than keep it in the family, making the next generation's role in the company fairly moot (only 8% of older companies, on the other hand, plan to sell in the next five years). A deeper, underlying reason for this divide may be a lack of confidence in the next generation's ability to take over, coupled with an unwillingness to let outsiders take over instead.

Regardless of when a business thinks a changing of the guard will take place, it's important to always have a plan ready for that eventuality, since unforeseen circumstances can cause a sudden need for new leadership. Companies that are three generations and older understand this better than their younger counterparts. Perhaps it's because they've experienced such unforeseen circumstances themselves (and, fortunately, have lived to tell the tale) or have been around long enough to watch and learn as other family firms dealt with the repercussions of inadequate succession planning.

Conversely, younger firms (1st/2nd gen), seem almost blithe in their inattention to succession planning. Over one-third have no succession plan whatsoever. More encouragingly, three-quarters of mature firms (3rd+ gen) do have a plan of some kind, although only about one-third of those plans are robust, documented, and communicated to the appropriate stakeholders. Having such a plan signals to key stakeholders that the business is here for the long term, whereas the absence of a plan casts uncertainty on the company's future.

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***“It’s important to demonstrate to future staff, especially nonfamily members, that while we can celebrate the family-business environment, there are opportunities for people to grow here. The nonfamily leadership roles are critical within family businesses. Without them, family firms are not seen in a good light.”***

**Nonfamily CEO,  
5th+ generation Maryland  
real estate firm**



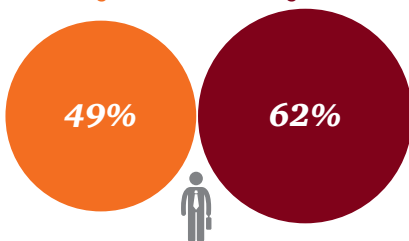
## Who's on the family firm's payroll?



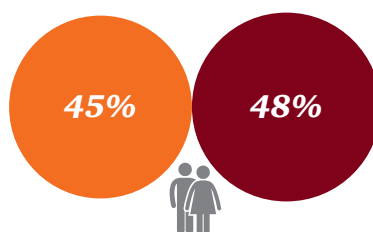
Older-generation firms are more apt to employ family as senior executives and issue company shares to family members who don't work in the firm

1st/2nd gen firms

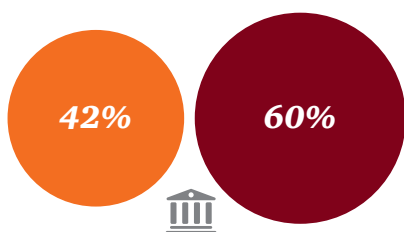
3rd+ gen firms



Family members work as senior executives



Family members work in non-executive roles



Family members hold company shares but don't work in the firm



Family members hold no role in the firm or any shares but receive other recompense

Q12: Currently, how many family members work for or are compensated by the company in the following ways?

## *Conclusion*



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Family firms remain a vital part of the US economy, but like all companies in a constantly changing business landscape, they need to remain vigilant. That means taking innovation seriously rather than continuing to do the same old thing. It means anticipating what's far over the horizon while also actively focusing on the middle distance between the horizon and where the company is now. In short, it means having a rigorous strategic plan.

It also requires family firms to take the following concerted actions:

- Redouble efforts around succession, beginning with a robust, documented, and well-communicated plan
- Determine how best to deliver on family businesses' belief in self-reinvention and sustained entrepreneurial spirit, with an eye on diversification in the face of industry disruption
- Think positively about the opportunities (and stark realities) that digital disruption presents for the long-term future of the business
- Empower the next generation, including women, who have a vital role to play in governance, strategy-setting, and all other aspects of the business
- Devote greater time and resources to professionalization, especially in relation to governance, including greater diversity on the board

While all of this is easier said than done, family firms are up to the challenge. Those that give it due attention are the ones who are likely to endure for generations to come.

# Endnotes

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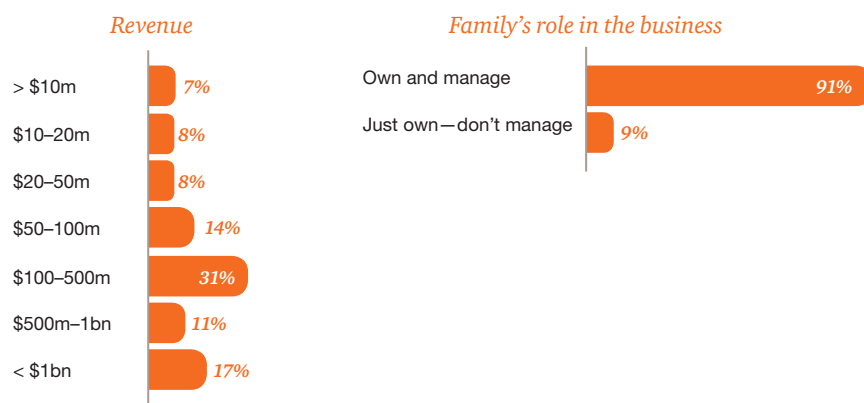
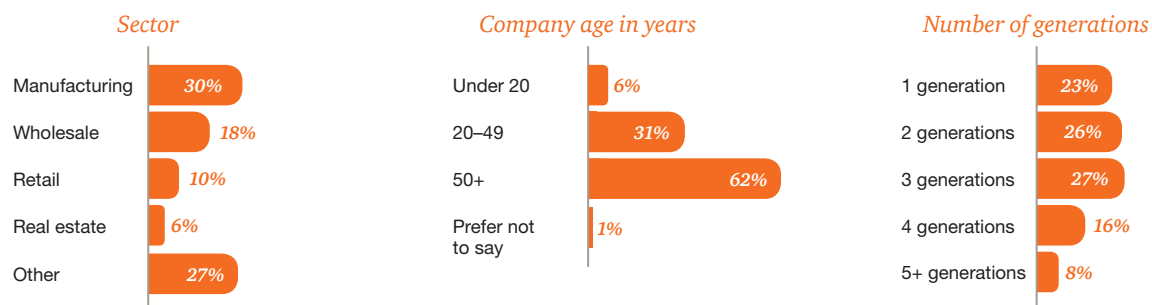
6 *Companies Behaving Responsibly: Gender Diversity on Boards*, Rachel Soares, Heather Foust-Cummings, Claude Francoeur, and Réal Labelle, New York: Catalyst, 2015

7 Spencer Stuart U.S. Board Index 2016

8 *2016 Annual Corporate Directors' Survey*, PwC, 2016

# Survey demographics

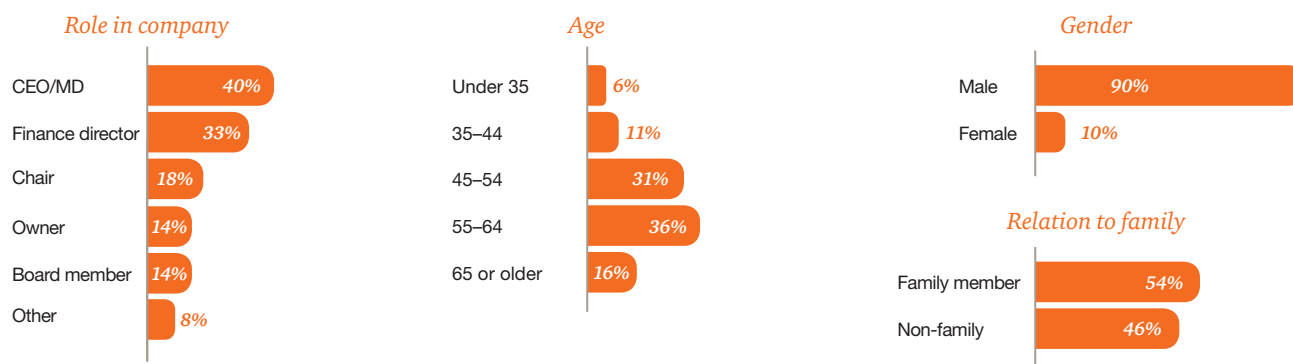
## Profile of surveyed businesses





# Survey demographics

## Profile of surveyed respondents



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