Creating stronger foundations for the future

How US family businesses can sustain their trust premium through digital transformations
Integrity and responsibility. Community dedication. Values such as these sustain over a million US family-owned firms, from the very large global businesses to local retailers, and form the foundation for a higher degree of trust from all stakeholders.

In the next two years, expect family businesses to rely even more on their operating principles and beliefs to stand out in a tight marketplace for the best talent and to preserve their reputation with customers. Over 70% of US family business leaders believe their company values create a competitive advantage, according to findings in PwC’s latest Global Family Business Survey.¹

At a time when trust is at a premium, these leaders recognize that US family businesses have built up reserves. They are trusted more ‘to do the right thing’ than non-family businesses.² Given the scale of changes predicted ahead in a far more digitally integrated US economy, employee and customer confidence is a good platform to have. They will want to use it wisely.

Many family businesses are expecting to see operational transformations take hold over the next two years, particularly as a result of returns on investments in technologies. Over half (52%) expect they will have made ‘significant’ strides in digital capabilities by 2020 compared with today. Maintaining the trust premium will require doing some things differently to galvanize innovation from employees and the next generation of family leaders, many of whom have stronger digital know-how than today’s leaders. They’ll be the ones charged with carrying the brand into a more automated age, with its own standards for customer experience, and bringing new skills into the workforce.
Securing the right talent to take the company forward is the top challenge identified by leaders, followed by spurring innovation. Toward this end, over the next two years, close to half (47%) of family businesses plan to bring in outside expertise to help run the company, while 39% expect it’s likely they’ll buy or merge into other companies. Most (62%) are also encouraging the next generation to gain work experience outside the family business, with the implication being they’ll bring that experience back into the business one day.

These are positive steps. Most family businesses have been through at least one cycle of disruption and sense that, once again, new offerings or efficiencies are advancing on the backs of location and sensor data, automation, and increasingly, artificial intelligence. One second-generation leader cites risks forming around “data-driven networks that we are left out of and less competitive as a result.”

More can be done. Maintaining this crucial advantage in stakeholder trust should lead to breaking some bad habits that can handicap a family-run business, such as putting off business continuity and succession planning. Just 18% of family businesses say they have a robust succession plan—that is, a documented and communicated leadership transition strategy—formally in place. This is not a new trend. Since 2014, the majority of US respondents don’t have formal succession plans.

This is the wrong time to get caught flat-footed. The pace of technological change is compounding the challenges for leaders everywhere in building a business that can thrive for generations. Lifespans of the largest US businesses in the S&P 500 are estimated to have contracted to below 20 years on average, due largely to the impact of technology disruption on their business.\(^3\)
While 37% of family leaders worry their businesses are vulnerable to digital disruption, up from 32% two years ago, we continue to see family businesses in a strong position to face the challenge. It’s not the technology that will determine the future of the business, but trust in the people behind it to deliver on the promise. Family enterprises innately understand this. It should help them navigate disruptions even as staying loyal to employees through significant, technology-driven changes in the business is hard to get right.

So how to turn values like loyalty into a multi-generational success story? Based on findings from US leaders, we see four moves ahead to consider in order to build a lasting and profitable legacy:

1. **Codify your values and purpose into your strategy**
   If this is where your family business has a competitive edge, take it to the next step. There are ways to make family values explicit and measurable to guide decision-making.

2. **Ensure the next generation is deeply involved**
   They have a lot to offer families grappling with digitalization. Their involvement will help them build a strong connection to the enterprise, too. Preparing for leadership should be a rising priority.

3. **Raise the digital IQ** of the business to activate new possibilities and draw out the best talent.

4. **Professionalize the board** by bringing in independent directors with external expertise in future growth areas for your business.

Informal governance is going to make success in today’s economy more difficult for family businesses. They’re still in a strong position. They’ve built up trust among loyal employees and their ownership group. Yet in the absence of a deliberate plan for success in a more digital economy or without the benefit of outside expertise, staying loyal to the employees and continuing profitable growth is going to be tough.

—Jonathan Flack
US Family Business Leader
These moves are interconnected. Thinking through the implications of a more digitally integrated economy should not be decoupled from thinking through who should run the business in the future and who can best help guide it. I hope that this report serves as a useful starting point for the conversations you will have with the current and next generation of leaders as you set a course for continued success. This effort would not have been possible without the participation of many family business leaders in the US. Thank you for taking the time to share your opinions and insights for PwC’s 2019 US Family Business Survey.

Jonathan Flack
US Family Business Leader

For a global perspective, download The values effect. Findings from PwC’s Global Family Business Survey show an enormous opportunity for family businesses to start generating real gains from their values and purpose by adopting an active approach that turns these into their most valuable asset.
Values and purpose are the backbone of strategy
We've owned this business for 70 years with the original intent of providing jobs and benefiting the community, and we have done that as we have expanded. We are investing in technology to allow us to continue to grow it.

—Leader of a third-generation US family business

As 2019 unfolds, US leaders are confident in prospects for their family businesses: 79% expect to deliver steady growth over the next two years with an additional 16% anticipating ‘quick and aggressive’ gains. Compared with company performance over the last year—with a total of 64% of respondents reporting positive growth—the outlook is bright.

At the same time, family businesses are positioning themselves for changes ahead. The need to be more innovative and access the right skills to stay ahead are the highest-ranking challenges they’ll face over the next two years. More leaders (85%) cite attracting and retaining the best talent as an important personal goal than improving profitability (76%). In fact, these goals are two sides of the same coin. Family businesses are straddling running a successful business today with planning for a future which may require different skills.

This is where strategic planning is essential. Digital disruption goes to the heart of some of the values family businesses hold dear. At the same time, failure to act is in itself a decision, albeit a passive one. A printing company with $15 million in annual profit failed to see the email writing on the wall. When electronic attachments all but replaced reports carried by postal workers, the fourth-generation company had to be sold. If a strategic plan had been created at the onset of the digital revolution 20 years earlier, the company likely would have diversified and remained viable.
It pays to plan ahead

By 2020, US family businesses expect to have experienced...

52% Significant strides in digital capabilities
47% Outside professionals helping to run business
16% Significant changes to the business model
39% Acquisitions or mergers with domestic companies

By 2020, almost all US family businesses survey respondents expect a mid-term strategy roadmap in place. Today, it’s a different story:

27% currently have no strategic plan at all
31% have an informal plan
42% are advanced. Plans are documented and budgeted with financial and non-financial KPIs to measure against

Our take
A strategy that codifies your values is a way to make better decisions
Creating a mid-term roadmap that can be tuned as needed is often one of the biggest missing pieces of the puzzle for family businesses. Our research shows family businesses that make their values explicit and measurable, and incorporate them into strategic plans, see better returns and greater longevity. Adopting an active stance towards values really pays off.
A broader definition of the purpose is vital to engage the next generation

The approach at Mars, Inc., is a good example of what it means to have values clarified, codified, and communicated. A diversified, global business in pet care, confectionery and food, Mars operates according to five principles that are deeply embedded in its culture.

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Business is more than earning a return. It is about the impact you have on the world, and that is absolutely important to the next generation.

—Victoria Mars, Mars, Inc.
Defining the role of business in five principles

Mars Inc., US

Victoria Mars, Member, Board of Directors
(Chairman of the Board from 2014 to 2017)

Businesses often display their principles and values on their website and in their marketing materials. Some even carve them onto the walls of their offices. But do they live by their principles in everything they do? Those looking from the outside at most businesses would probably need some convincing. One company that might convince them is the family-owned business Mars. A diversified, global business in pet care, confectionery and food, Mars operates according to five principles that are deeply embedded in the company’s culture.

The Five Principles are: quality, responsibility, mutuality, efficiency and freedom. “There’s not a conversation I have with our associates and leaders, other corporations, government officials, or when I speak in public that doesn’t weave in The Five Principles,” says Victoria Mars. Mars, the former chairman and current director of the Virginia-based company and a member of the fourth generation of the family owners, stresses the importance of nurturing these principles. “Repeat, repeat, repeat; demonstrate, demonstrate, demonstrate The Five Principles all the time. It’s so critical you don’t forget about these five principles.”

Mars is one of the biggest privately-owned businesses in the world, and it employs more than 100,000 people in 80 countries. The company’s five principles, which are visibly present in each of its hundreds of sites, unite Mars associates across geographies, languages, cultures and generations.

The company’s approach makes a good example of what it means to have values clarified, codified and communicated. The principles are not only written down, but are brought to life in detail in a 26-page document on the company’s website. In it, each value is given practical relevance and application for employees, suppliers and other stakeholders.

For instance, much is made of the way in which Mars is a decentralized organization in which employees – which it calls associates – are given the “freedom to act with full responsibility for doing their assigned jobs.” In the workplace,
“divisive privileges” are to be avoided, and an egalitarian spirit is encouraged.

Under the principle of mutuality, the company holds that its business relationships should be measured by the degree to which they create mutual benefits for the company and its stakeholders. Success is achieved if quality and value are given to customers, suppliers, distributors and others. “Gains that ignore this will be short-lived” is the powerful warning in this section.

The fifth principle, freedom, takes as its starting point the “deliberate choice” that Mars is a privately held company. Free from what Mars calls the “restrictions” of having to incur debt to grow – as many publicly listed companies do – the company has more control over its affairs. It has the freedom to re-invest a substantial portion of its profits each year. “As long as Mars remains free, our well-being can always come before any other financial priority,” the company states in its description of this fifth guiding principle.

Victoria Mars says it’s unlikely the company would have been as successful building its business without The Five Principles. “From one generation to the next, it was always about how we did business rather than what we do as a business, and The Five Principles came out of that legacy,” she says.

The values embedded in the principles come from Mars’ grandfather, Forrest Mars, Sr., whose father, Frank, founded Mars as a confectionery company – a precursor of today’s Mars company – in the US state of Washington in 1911.

“My grandfather was a great believer in how you do business,” says Mars. “Around 15 years ago, we found a letter written by him in 1947 that talked about this idea of mutuality with your associates, your community and all your business dealings as the very objective for the company’s existence. This has shaped the family’s values and principles, and was further expanded when my father, my uncle and my aunt codified The Five Principles in the early 1980s. They have been updated a few times, but what hasn’t changed is the principles themselves. What evolves more constantly is the relevance of how one lives them in the current times.

"As a child, I grew up with these principles as part of how we lived as a family. They weren’t hanging on a wall, posted on the kitchen fridge. But they guided our family and me on how we interacted with people. I thought this was just the norm.”
For the Mars family, having these principles helps the family steer what it believes is the right course for the business – and the principles are not open to challenge, as Mars explains. “You can get managers that can come along who might say we need to change aspects of the principles, but the family will say: ‘You don’t understand; these are our principles, our values. You don’t have the right to change them.’ We own these principles and values. The business doesn’t own them; we own them. The real connector between the family and the company are The Five Principles of how we do business. It’s the glue that holds us together.”

What these principles can mean in practice has recently been demonstrated in the launch of the company’s ‘Sustainable in a Generation’ plan. This comprehensive programme was launched in 2017 and has three pillars that the company is working to create through its operations: ‘healthy planet’, focused on climate change, land and water stewardship and waste management; ‘thriving people’, focused on, among other things, increasing incomes and unlocking opportunities for smallholder farmers in the company’s supply chain, including disadvantaged women; and ‘nourishing wellbeing’, focused on health issues among people and – naturally – their pets, too.

Another practical expression of the company’s principles is highlighted by their use in helping to recruit the right talent, says Mars. “Our principles and values will attract the associates we are looking for to work in our business and will keep the ones we have working for us. They will encourage consumers to buy our products and affect how communities we work in feel about us being part of their communities, and how governments feel about us working in their country.”

Mars also believes a broader definition of the purpose of business is vital to engage the next generation. “Business is more than earning a return. It is about the impact you have on the world, and that is absolutely important to the next generation,” she says.

“As the fourth generation of our family, my siblings, cousins and I are asking ourselves how we are going to keep our children, grandchildren, and great-grandchildren connected to the business when they aren’t going to be as closely linked as we are,” Mars notes. “We’ve got to find another way to connect them. It’s easy to end up with just words on a wall; you have to keep training, telling stories and demonstrating how you behave and show how to live by these principles.”

The Global report includes in-depth interviews with leaders from an additional 9 global family businesses. Find the Global report at https://www.pwc.com/fambizsurvey
Ensure the next generation is deeply involved
In making the transition from first generation to second, the enterprise faces the transformation from start-up entrepreneur to a more structured, complex organization. This is the most difficult transition for family businesses; not all will succeed. About a third of family businesses are expected to last beyond the founders’ generation while even less—an estimated 12%—will make it to a third generation.\(^4\)

There are ways to get ahead of the trend. In guiding families through this process, we find that transparency is vital. When everyone is involved, and the process is collaborative, the result is much more successful than if a top-down decision is simply delivered. A family council is helpful to this process, with an inclusive approach rather than an autocratic one.

“If they (next gen) want to be in the business, they have to be capable of being in the business and know that while there is a little bit of a thumb on the scale, it’s not a very big thumb.”
—Leader of a third-generation US family business
Preparing the next generation to lead the family business

Most family business leaders today want the next generation to succeed

- 62% of family leaders plan to pass the business on to the next generation
- 39% will pass on leadership within five years

The next generation has a clear vision of the future of its family business, and strong ideas about how to get there

- 75% of next gens have big plans about taking the business forward
- 7% of next gens think their family business has a strategy fit for the digital age

How some family businesses are preparing the next generation to safeguard business continuity

- 62% expect upcoming family members gain outside work experience
- 58% have succession plans, however most are informal
- 47% of next generation leaders take on non-senior roles in the business
- 39% sit on the board of directors

Our take

More can be done

- To encourage next generation success, think of the roles that cannot be outsourced but are integral to family ownership, such as positions in the family office, leading the foundation or the family council.

- Transparency is vital. Communication protocols make it easier to remove some of the emotion from what can be a very sensitive set of decisions.

- Consider continuity planning that also incorporates leadership and management well into the future. A skills assessment will reveal what you need today and what you will need tomorrow.

Base: 168 US family business leaders

Sources: Global Family Business Survey, PwC, 2018; Same passions, different paths, PwC, 2017.
Raise the digital IQ
Today’s digital technologies involve unprecedented breadth and scale. Yet the constraint for most companies will not be the technology. It will be their ability to employ digital technologies to take advantage of the lower cost, a more effective approach to customer demand, and making better use of assets.

That is why raising the ‘digital IQ’ of the business is closely entwined with raising the digital capabilities of the existing workforce and determining the skill sets needed for a more digital future. US family business leaders are aware of the challenges. Innovation and skills gaps were the two biggest challenges mentioned, while business leaders cited hiring, keeping, and rewarding employees as top priorities.

One place to start is the board, where a strong combination of directors with the right skills can be hugely beneficial as family businesses look to tackle digitalization. Another focus can be on millennials, who are the best-educated generation in history and are extremely tech-savvy. Part of a family business legacy will be determined by the way in which the next generation is encouraged and groomed to be involved.
Most family businesses have been through at least one cycle of disruption. They will gain confidence from past transformations to meet today’s digital challenges. Cretex, a diversified group focused on medical, aerospace and defense, infrastructure and industrial, based in Minnesota, has been investing heavily in technology that is directly linked to the manufacturing process and sees itself as leading the industry in technologies like additive manufacturing and 3-D printing. Yet Chief Financial Officer Steve Ragaller notes, “there’s the whole other side of technology that is the digitalization of business processes and the communication between you and the customer—shortening the time frame associated with all the activities before you get to manufacturing a product. That, we’re not leading in, and that’s where my biggest concern is.”

Integrating employees with an appetite for change and training existing employees in adaptive processes that favor agility and automation can provide a welcome variety of viewpoints and ideas.

**Read more:**

Doing digital right doesn’t mean you need to become the next Amazon or Netflix. But it does mean you may need to change your ways to maximize the potential to drive new business. *The no-excuses way to win in a digital world*

Technological changes foreshadow a dramatic—but manageable—shift in business logic everywhere. *The Coming Wave of Digital Disruption*
Preparing for the next wave of digital disruption

With the artificial intelligence (AI) revolution taking shape, business leaders sense that what it takes to be digitally competitive is moving at a fast pace.

More worry their businesses are vulnerable to digital disruption

Specific technology challenges for family businesses globally

The pace of technological change is compounding the challenges in building a business that can thrive for generations

<table>
<thead>
<tr>
<th>Current</th>
<th>Two Years Ago</th>
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<td>37%</td>
<td>32%</td>
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- 44% Digitalization
- 22% Growth of AI and robotics
- 39% Cybersecurity

Average age of a company listed on the S&P 500

- 1950s: 60 years
- 2012: > 20 years

We asked 168 US family businesses to describe why they feel most vulnerable to digital disruption. Here is a sample of their remarks:

- Brand losing its relevance in the digital online world.
- The gap in customer expectations. Older people don’t like technology and younger ones love it.
- Others are using AI to become more efficient in producing what we do.
- Our competitors can view and target our clients, suppliers and vendors.
- Sensitive data can compromised, including customer profile data, credit cards and sales records.

Apprehension over keeping the family business safe is higher among US family businesses

- 57% feel vulnerable to cyber attacks
- 40% of respondents globally

Businesses worldwide are estimated to spend nearly $135 billion in 2022 on cybersecurity. However, data breaches are likely to cost businesses more in fines, lost business and remediation costs.

Our take

Family businesses are waking up to the disruptive reality of AI

We believe AI will impact employers before it impacts employment, with AI encouraging a gradual evolution in the job market that—with the right preparation—will be positive. How can family businesses improve their readiness? One place to start is the board, where a strong combination of directors with the right skills can be hugely beneficial as family businesses look to tackle digitalization. An important part of the legacy will be determined by the way in which family businesses encourage the next generation to be involved. We have found that young family members engaged in the business are already making a difference in digital technology.

Sources:

- Global Family Business Survey, PwC, 2018
- Klerk, Eugene, Global Equity Themes: Disruptive forces in Europe: A Primer, 2017, Credit Suisse Equity Research
- AI predictions, PwC, 2018.
- Same passions, different paths, PwC, 2017.
Professionalize the board
As a family firm grows and becomes more complex, the board typically evolves with it, adapting more formal processes and policies to support the long-term health of the business. We continue to see family companies more interested in corporate governance than we did a decade ago. Today, 80% of US respondents say the board of directors are involved in developing and agreeing on a strategic plan for the business.

Over the next few years—given the scale of technologically driven change, among other factors shaping the future of the US economy—we expect the natural evolution of family boards to accelerate. More families are likely to turn to outsiders to fill a gap in experience that the company feels it doesn’t have, as leaders look for fresh perspectives and guidance to help the business adapt.

Yet bringing in an outside advisor or more formally, an independent director, is not a small step. It very often means bringing in people who are not family members, trusted long-time advisors or from company management. It moves the business closer to a governance model found in public companies, where boards have distinct roles and oversight responsibilities. And that means the board will behave differently.
New skill sets in demand for directors

The rise of outside advisors to family councils or as directors on leadership boards reflects the degree of strategic rethinking taking place inside many firms. The skill sets leaders look for to provide knowledge and guidance are widening. For example, we’re seeing rising interest for board candidates who have had responsibility over large-scale information technology (IT) implementations or knowledge of cybersecurity and other IT risks.

This isn’t surprising. Firms are making substantial investments in technology. Over half (52%) of family business leaders expect to have made ‘significant’ strides in digital capabilities in the next two years. At the same time, concerns are growing over vulnerabilities to digital disruption and risks, particularly in cybersecurity. Having someone on the board who is knowledgeable about these risks is crucial. We’re also seeing larger companies that are expanding internationally or moving into different product areas extend their search for advisors that include outside professionals with knowledge of those markets or industries. And there is growing interest in achieving board diversity. For example, among US respondents, on average, 22% of people on the board are women.

Rising private equity interest is another driver

Greater willingness to explore alternative sources for financing are another factor driving efforts to strengthen the board and take steps to separate ownership and management. Over a third of US respondents are open to bringing in private equity to help fund the business over the next two years. Historically, when we have asked family businesses how they might raise funds for diversification and growth, private equity has not factored as strongly.

We are seeing a shift of attitude on both sides. On the private equity side, several global private equity houses are renewing their focus on the family business sector and carving out teams with the right skills and experience for the space. For family businesses, the right partner can help improve governance and procedures as well as challenge management.
Finding the right mix for the board

Independent directors will move the board away from a focus on day-to-day operations to one of true oversight. Outside advisors bring objectivity and accountability to the board and they will expect their input to be respected. They’ll require formal governance structures and processes to do their part well.

Yet changing the balance of family and non-family members on the board can create tension. Being transparent about the need for a professional board is crucial for its success, while defining the roles and responsibilities will influence how effective the entire board will ultimately be. The move from entrepreneurial start-up to a business being structured for long-term growth will be felt in varying degrees throughout the organization, but often most acutely at the board as its role changes. Families that formalize governance are, in effect, mapping out where they believe success for the company lies and which skill sets are needed to get there.

Read more:
Lee Kum Kee Company, Ltd., famous for its oyster sauce, formalized a family and business governance structure.

Interview with Eddy Lee, Director and Chairman of Lee Kum Kee Family Investments Ltd.

Learn more about building or renewing your board and how evolving your governance model might help your company.

PwC’s Family Business Corporate Governance Series
Professionalizing the family business board

The move from entrepreneurial startup to a business being structured for long-term growth will be felt in varying degrees throughout the family business, but often most acutely at the board for its role will change in important ways.

**Evolution of the family board.**

**Today:**

- Directors involved in developing the strategic plan: 80%
- Next generation sit on the board of directors: 39%

The mix of internal and external directors tends to evolve based on owners’ desire for a stronger board. At some point, the benefits of outside expertise and fresh perspectives, as well as shared accountability over major matters like the strategy roadmap or succession planning, begin to outweigh the (implied) loss of control. When a majority of directors are independent, or have no employment or other ties to the company, the board is closest to a public company governance model. A majority independent board will require formal governance structures and processes to do their part well.

**Our take**

Highly effective boards include a mix of directors with the expertise and experience to provide true oversight. Finding the right fit for the family from a cultural and philosophical standpoint is important. Your directors must work well and effectively with you and your family in an environment of trust. To make this transition to a professional board successful, we recommend these steps:

- Build a well-balanced board, containing a variety of skill sets and experience as well as diversity.
- Think broadly of what the business needs. There are times when an advisor without deep knowledge of the family business may be better placed to recognize risk trends and patterns.
- Document the board’s roles and responsibilities.
- Uncover the gaps in skills and knowledge needed on the board through a formal assessment process, driven by the company’s future strategy.
- Integrate technological expertise to guide digital development and cyber threats. This can be done at the board level or accomplished with external advisors or IT consultants who can provide the board with assurance that the company is well prepared for digital opportunities as well as risks.
- Recruit at least two independent directors if this is your first move towards non-family members. A lone independent can be overwhelmed by the family dynamic.
Conclusion

The values that sparked your company’s inception continue to fuel its philosophy and commitment. The rapid pace of change requires new tools and processes, and there is paperwork to be done to ensure the business’s future, but the underlying values that are built on trust are the bedrock that future generations will rely on when their challenges rise to be met. Today’s business leaders have the opportunity to align those values to ensure an enduring legacy.

1 This report is based on 168 US respondents to PwC’s ninth Global Family Business Survey, which incorporates the views of 2,953 companies around the world, surveyed between 20 April and 10 August 2018. US respondents represent a range of industries and 59% are based in businesses that generate at least $101 million in annual revenue. The Global report also includes in-depth interviews with leaders from 10 global family businesses. Find the Global report at https://www.pwc.com/gx/en/services/family-business/family-business-survey-2018.html

2 A 2017 Edelman Trust Barometer report found that family businesses are more trusted than non-family businesses by a 16-point margin globally and by a 24-point spread in the US.


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