KPMG

cutting through complexity

Family Business Advisory

From concept to road map

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Foreword

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“Our goal is to help create harmony and long-term prosperity for family-run businesses. While accumulating and preserving wealth are important goals in their own right, the ‘family factor’ must be carefully considered in order to establish financial goals that can span generations.

Realising the full potential of the business while satisfying the expectations of family members can sometimes be challenging – but it is certainly achievable with the right kind of help.”

Pillars of success for family businesses

Family businesses are unique. What makes them different is the family dynamic, which can play a significant role in decision-making and offers both opportunities and challenges.

Does everyone in your family share the same vision?

The growth and sustainability of a family business lies in the fine balance between the needs of the business and the expectations of family members. KPMG member firms have used their knowledge and experience with family businesses around the world to identify seven key pillars that family-owned companies can address to help serve the best interests of both the family and the business.

Be part of the conversation

Our dedicated Family Business blog, www.kpmgfamilybusiness.com, features publications, case studies, surveys and opinions on family business.

Ask questions and engage with our family business advisers by taking part in the conversation online, and join KPMG's Family Business community on LinkedIn and Twitter.

Succession & integrating the next generation

> **"As we move to third-generation ownership, we don't expect our successors to carry on in the same way we did – but I'm not just going to hand it over. This business is the wealth and the security of the family going forward. It's not about a successor; it's about a succession process."**
>
> *Third-generation family business owner*

Sustaining a family business beyond generations is often a challenge, and fewer than half of all family businesses survive the transition from one generation to the next.* Families in business have an opportunity to create a lasting legacy that brings with it a sense of accomplishment and pride. However, succession and integrating the next generation into business is perhaps the toughest and most critical challenge of a family business, involving business management and ownership succession, as well as leadership development.

**Source: Family Firm Institute (FFI)*

Succession calls for the transition of both management and ownership. Both transitions can take place simultaneously or can be done one step at a time. Succession planning ahead of time can help families avoid conflict and ensure the needs of the business are met when the time to transfer ownership of the business is right. It is important to understand the next generation's aspirations and have the best transition plan in place.

? Questions to consider

Does your succession plan include both ownership and management aspects?

Ownership

Ensuring that the transfer of ownership of the business is done at the right time and is well communicated is crucial to its future success.

- How will you organise and secure family ownership in the event of family dissension?
- Is your legal structure set up in the best way in order to maintain family ownership when non-family financial investors are involved?
- How and when will you transfer shares to the next generation?

Business management

Careful consideration should be given to business management in the succession planning process to ensure that you have the right mix of talent to lead the company.

- How do you motivate the next generation to take part in the management of the company?
- What is the best way to organise the leadership of the company and the presence of non-family members?
- How do you prevent family disagreements from negatively impacting the management of the business?

How we can help

KPMG China's family business advisers can help you develop effective processes and activities that are designed to achieve long-term prosperity and family harmony. By conducting confidential discussions to gain an understanding of your issues and concerns, advisers can suggest options based on our experience helping family businesses.

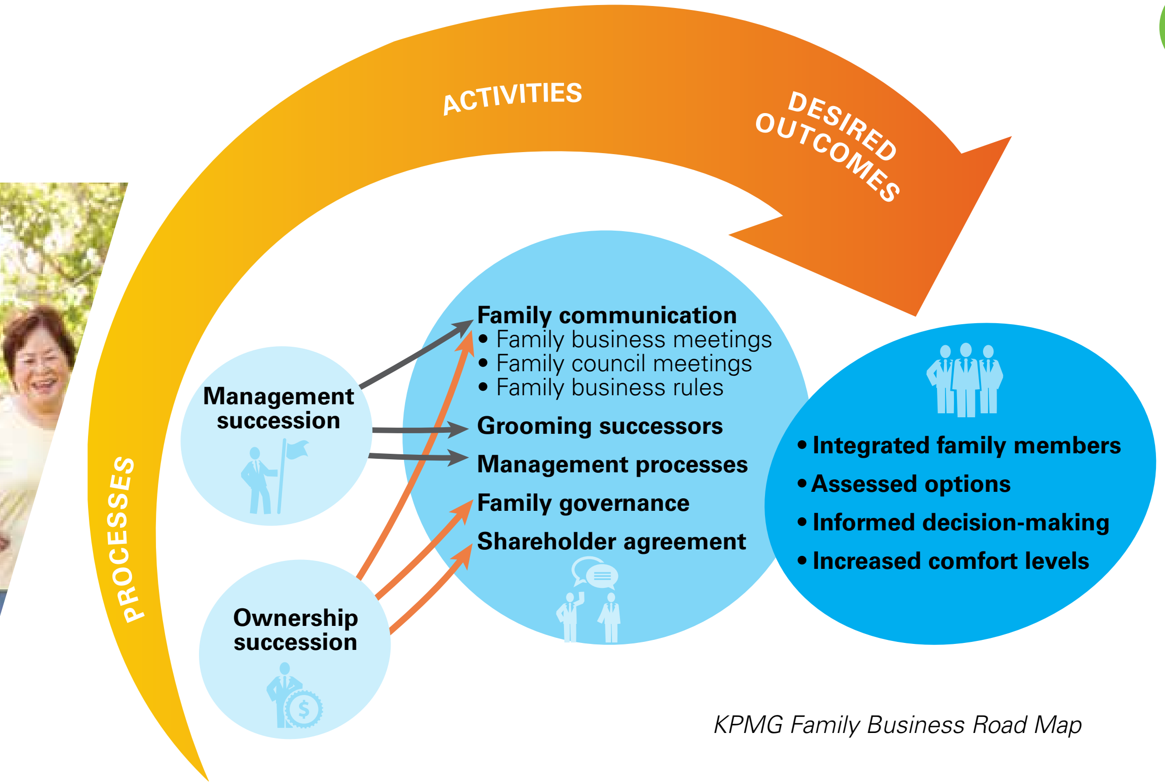
For example, to help ensure that the decision-making process supports the business and the family, discussions can be facilitated with individual family members, key non-family management employees, and other stakeholders to obtain a holistic view of various aspects of the business.

These discussions can help determine:

- The wishes and aspirations of the lead entrepreneur as well as the business's active and non-active family members
- The values, beliefs and vision of the family
- The family principles with respect to succession
- The family business rules regarding integrating the next generation.

Once a holistic view of the business has been obtained, the advisers can work with the family to devise a road map for succession and highlight key areas to watch closely which may include:

- Relational dynamics between family and non-family members in the business
- Skill set gap analysis for successors
- Communication of the road map to the family and company
- Tax implications of the transition
- Timing of the share transfer to the next generation.



KPMG Family Business Road Map

Example scenario – Dealing with succession

Mrs Chan, the founder of a family business, has two sons and a daughter. As she gets older, she sets up a trust to distribute equal shares in the company to her three children.

The three siblings all work in the family business but have differing views on the future development of the company. In fact, one of the sons wants to exit the business and pursue other interests. However, the siblings have not discussed this sensitive topic as they do not want to be seen as disloyal to the family.

By the time two of the grandchildren from the third generation are old enough to work in the business, the market has changed significantly and the company is experiencing headwinds. However, since there is no consensus from the second generation on the future direction of the business, the organisation does not invest in its people or its operations.

The business gradually becomes uncompetitive, but the family continues to operate the company at a loss to maintain the family name. The grandchildren do not know how to proceed as the shareholders have not made their intentions clear, and the business continues to become increasingly uncompetitive.

Governance

Sustaining a family business beyond a couple of generations can be difficult.

It is often said that the typical family business goes from rags to riches and back to rags in three generations. Governance really means adopting a decision-making process. Better governance of a family business can help improve business performance and satisfy family members' expectations.

Family business rules

You don't need them – until you need them
Family members can have different perspectives and ambitions depending on their role in the business, the family and as owners. Disputes can paralyse the management of the enterprise, endangering the very existence of the business, and, most importantly, the family relationship.

Times of transition are especially sensitive and it is common for families to have differing views on what the rules governing the business should be. It is far better to have guidelines created when everyone is getting along, prior to major events in a family business. Likewise, when a business reaches a size and complexity unsuited to more informal management styles, the time may have come to consider a more effective governance structure.

When family business rules or guidelines have been put in place, everyone knows what is acceptable and there is less risk of problems arising.

? Questions to consider

Trying to manage differing opinions and family disputes can leave family business leaders grappling with some or all of these anxieties:

- Is there a process in place to resolve conflicts within the family?
- Is there a clearly defined process for hiring, assessing and remunerating family members employed in the business?
- How do you manage minority shareholders' expectations?
- How do you define and separate family and business issues and decisions?
- Do you have an effective structure for decision-making and communication?
- Do your strategic business objectives reflect your agreed-upon family values and aspirations for the business?

How we can help

While the risk of family conflict can never be entirely eliminated, family business advisers understand the impact of family dynamics on your business and can work with you to put governance structures in place to help you achieve long-term prosperity and family harmony. By helping companies establish a dialogue between family members, create a family council or board of directors, and develop a family constitution and code of conduct, the advisers can help sustain the business through generations.

Best practices in good governance

To create a governance structure that works for your family and business, there are three different areas to consider: the needs of the family, the business and the ownership. Each of these areas must be addressed if you want to achieve your goals and find the right structural balance.

	Leading practices	Governance structures	Outcomes
Family	• Develop communication channels • Create a family constitution to help resolve future conflict • Appoint an advisory board that includes non-family members • Establish guidelines and policies to help decision-making	• Family councils • Family assemblies	• Family code of conduct • Family constitution
Business	• Understand the risks in your business • Develop a clear strategic vision • Monitor and evaluate key business performance indicators • Implement an effective assurance framework	• Boards of directors • Advisory boards	• Strategic plan
Ownership 	• Develop a shareholders' agreement that includes management and succession objectives • Establish ownership criteria for family members • Establish an education plan for the next generation regarding ownership rights and responsibilities	• Shareholder assemblies • Shareholder meetings	• Unanimous shareholders' agreement • Ownership succession plan • Estate plan

Growth

Achieving profitable growth for your business

Sustainable and profitable growth is essential to continued business success. Companies that do not grow or put strategies in place to address stagnant growth risk being outmanoeuvred by new and existing competitors.

While many businesses can achieve growth organically, this can require considerable time and effort. Agreeing on when and how to grow can also often be a challenge for family businesses. A growth plan supported and understood by family members can enhance family harmony, and innovation can be sparked by engaging the next generation in the growth strategy.

There are five key tactics that business owners can implement to help achieve profitable growth:

1. **Introduce new products or services**
2. **Acquire other businesses**
3. **Increase prices**
4. **Expand into new markets**
5. **Grow your customer base**

Taking the next step

Implementation is essential. Conducting a thorough assessment of your company and identifying opportunities for growth are critical when planning your strategy, but following through is the most important part. In many cases, this is where companies fall short – they know how they can grow but do not take the action and necessary steps to fulfil their strategy. Ensuring that your company executes its growth strategy can make the difference between a business that succeeds and a business that falls short.

? Questions to consider

The larger the business, the higher the likelihood of experiencing increased complexity and costs.

- Can the business's future capital requirement be satisfied under continuing family ownership?
- Does the family ownership and management have the necessary expertise and contacts to grow?
- What strategies can be put in place to rapidly and successfully integrate new acquisitions in the family group?
- What are the best ways to deal with the uncertainties and risks that growth presents?
- Is the company prepared for international expansion?

How we can help

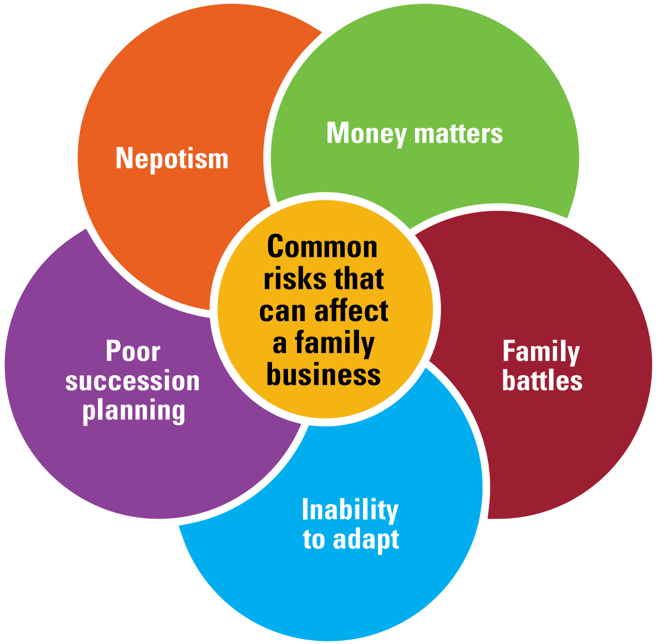
For a family business to adapt and remain competitive, a growth strategy is required. Family businesses must consider all of their market opportunities including seeking out complementary businesses for acquisition, potentially divesting non-core businesses, outsourcing functions to increase cost efficiencies and potentially expanding into emerging markets.

There is no one-size-fits-all answer – KPMG China's advisers can help you explore your options and find the approach that suits your business and family. Once you have decided what route you want to take, the advisers can work with you to implement your growth strategy.

How do you know if your company is ready to grow and what strategies are best? Consider assessing your capabilities in the following key areas:

- **Value creation**
  Does your company periodically review the markets/segments it serves for development potential, changes to customer preferences, quality positioning and costs?
- **Strategy and business planning**
  Does your company have an inspiring and clear vision for the next three to five years that provides a basis for focus, direction and goal setting?
- **Business structure, operations & finance**
  Does your company have financial and management reporting processes that provide reliable information at the right time for decision-making and reporting?
- **Human resources**
  Does your compensation programme reward results fairly and positively influence behaviours?
- **Information technology**
  Does your company make investments in information technology that generate measurable value for the business?
- **Governance**
  Does your company have regular board or advisory committee meetings to provide input on direction and important decisions?

Assurance



Could your business be at risk?

The need for effective risk and controls management is crucial in an environment of increased scrutiny. It is important to manage these risks in a family-run business – not only for the business itself, but also for the family, property holdings and capital.

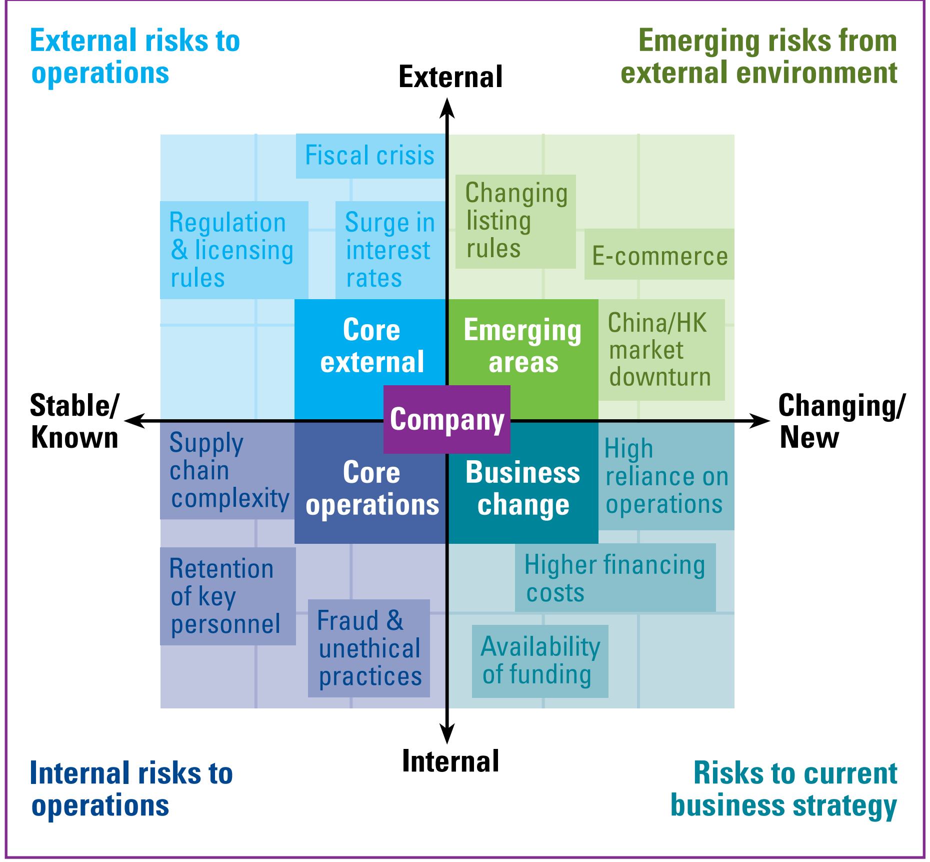
By managing internal and external risks, opportunities can also be created. The following can have a positive impact on the bottom line of the business:

- Implementing **controls**
- Securing new **financing**
- Applying efficient **tax management** and **optimisation**.

Why address risk?

There are many benefits to addressing risk. A strategic and effective approach to risk management can improve decision-making, increase accountability, focus resources in areas of highest risk, and increase your success in meeting business objectives.

An example of a risk universe



? Questions to consider

- Do you have a systematic methodology for assessing the risks to your family business?
- What internal and external controls do you have for the business to help safeguard you from any 'surprises'?
- Are you equipped to protect your company's technology and processes against unauthorised access?
- What are the best tax strategies for your family business and for family members?
- How do you measure the return on investment of risk management?
- How do you prioritise communication for your family business in order to define its processes, value and effectiveness to key stakeholders?
- Do you have agreed-upon guiding principles and abide by them to reduce conflicts in your family business?

How we can help

A family business has unique risks. KPMG China's family business advisers can help you understand and address your company's vulnerabilities – from both a business and a family perspective.

We work with family businesses to develop strategies that can help them manage risk and thrive. Family businesses that have applied these strategies tend to do well in their markets and continue for many generations. We can assist with the following:

- Establishing regular family meetings, which can help keep the lines of communication open and act as a forum for family members to voice their opinions about business and ownership issues
- Assessing the return on investment, which can ensure that the return is commensurate with the level of risk acceptable to the family and the business
- Creating an effective and compliant tax strategy which can help maximise after-tax cash flow
- Putting in place proper fiscal and governance measures and reviewing them regularly to help ensure that the business runs as just that – a business
- Evaluating the financing structure to reduce risk and ensure future flexibility to meet the strategic objectives of the business and family
- Applying internal controls that are suitable for the complexity and maturity of the business to help prevent undesirable activities.

While risks can never be eliminated, being aware of what they are and where they come from can help you steer a course to success for both your business and your family.

KPMG China's family business advisers can help you be proactive, assess your risk areas and put strategies in place to help you gain control of your:

- Financing
- Tax management
- Control implementation.

Example scenario – Protecting against risk

The To family business has been operating for more than 30 years. The founder and his son, Jason, have worked together effectively to develop the business.

The company's finance function is predominantly made up of trusted employees who have been with the business for a long time. The treasury function does not have a specific framework or control procedures, and the employees mainly defer the decision-making to Jason.

Jason is the main contact for the business's key bankers. The bankers frequently recommend foreign exchange hedging instruments to Jason, as the company's expenses and sales are in different currencies. The instruments' risks seem to be reasonable based on the historic trends of the currencies involved.

However, one of the countries experiences sudden changes in central banking policies and its currency inflates overnight, resulting in the company facing significant and ongoing losses from the hedging instruments. The board then begins questioning the control and approval procedures for the purchase of derivative instruments.

Exit strategies

Sometimes, an exit strategy rather than a succession plan is needed. This may be because the market has changed or there is no ‘next generation’ of family members which is ready, willing or able to continue the business.

To enhance the value of a business, it should be managed as if it is for sale every day. It can be beneficial to spend the time now to improve cash management procedures, establish a governance framework or make changes to improve employee retention – in future, these efforts may allow you to attract qualified buyers more quickly, and possibly get a better price.

Overview of the sale process

The sale of your business can be viewed in five distinct phases, which each include different considerations and action items. However, one phase should always be used before and throughout the process – preparation.

1. Preparing & getting your business in shape
2. Finding a buyer
3. Pitching to market
4. Conducting due diligence
5. Negotiating and closing

Post-sale strategies

The exit strategy process does not stop at the sale of your business. Once your business has been sold, it is time to consider how to invest the proceeds of your sale in a way that benefits you and your family.

You will need to think about:

- The best way to reinvest the proceeds for the future of the family
- Which investment options will suit your future needs
- What philanthropic goals you would like to achieve to leave a lasting legacy
- Whether you intend to start a new business.

Questions to consider

There are a myriad of questions to consider when contemplating exiting your business, including:

- What is your business worth?
- How can you maximise the value of your business?
- When, how and what part of the business should be sold?
- What are your options when considering selling your business?
- What will happen to the business if you decide to sell?
- How do you find a buyer?
- If you received an offer today, would you be willing to sell?
- What legal and tax strategies need to be put in place?

How we can help

When selling your business, there is one opportunity to get it right. However, there are many options when considering an exit from the family-run business. KPMG's advisers can work with you to examine your options and assist with the issues discussed here.

KPMG China's family business advisers have experience selling companies and enhancing value for the business owner, and can assist with:

- Conducting valuations
- Securing buyers
- Negotiating
- Completing transactions
- Dealing with tax implications.

Advisers can advise you and help you increase the value of the business.

Exiting your business can be one of the biggest life decisions you will ever make, and having the right advice and support can reduce the uncertainty of the process. It is never too early to start getting your business in shape.

Wealth preservation

Preserving wealth for generations

A solid plan to preserve wealth is vital for any private company, but particularly for a family business. Often, the long-term vision of wealth preservation is misunderstood by family members, particularly the next generation. Wealth preservation therefore requires careful planning to prepare family members for the responsibility and emotional impact of wealth, and to protect business assets.

Having a governance structure in place before problems arise can guide decision-making and ensure open and honest communication. This is especially important during discussions about wealth preservation. Other key components for accumulating and preserving wealth include:

- Developing and implementing a wealth management strategy
- Monitoring and modifying the strategy to accommodate change.

Family office

In family business, personal and operational assets are frequently held under the same organisational structure, and personal assets are managed by the operational management team. More and more, we see families separating the holding and management of personal assets and family-related administration into a single or multi-family office. We expect this trend to continue expanding in Asia in the coming years.

Questions to consider

- Have you considered setting up a family office?
- Are your personal and operational assets held and managed under the same organisational structure?
- Are all of your family's assets (both tangible and intangible) well insured?
- Do you know the key principles regarding wealth management and how to implement them?
- Are you comfortable with your cash flow needs and your ability to manage liquidity?
- Is there a way to optimise the structure of your assets?

How we can help

Conducting an inventory is the first step in wealth preservation. This includes having a full understanding of all of the assets (tangible and intangible) associated with the family and the business, and shining a light on gaps and risks that may exist within your current portfolio of assets.

After considering your options for wealth preservation, it is time to implement the plan. We can help facilitate your plan, which could include a combination of the following:

- Family offices (managing various aspects for the family, such as investments, governance and trusts)
- Tax planning strategies, including cross-border considerations
- Retirement plans
- Estate planning (wills, trusts, shareholder agreements)
- Charitable giving (foundations, trusts).

One of the keys to implementing your wealth preservation plan is to ensure that it is **flexible** enough to accommodate changes that might occur in the family or the business.

Example scenario – Preserving wealth for future generations

David, the founder of a family business, had children late in life. He had been operating the company with professional managers, and hoped to pass the business to his children when they were old enough.

The company had initially been running effectively, and expanded its operations through a joint venture with a third party. The profits had been good for a number of years and David decided to use these profits to purchase properties and establish an investment portfolio, both of which were held under investment entities owned by the operating company.

However, over the years, business conditions deteriorated and the operating landscape became increasingly complex. In his later years, David found it difficult to adapt to the changing environment and relied heavily on his professional managers.

As conditions worsened, the joint venture partner ended up suing the company, as it had been discovered that one of the professional managers had been siphoning money from the joint venture and the business to pay himself and government officials. David now faces the possibility of losing all his wealth as the majority of his assets are retained in the corporate structure which is now being investigated for fraudulent activities.

Philanthropy

Giving back – Creating value through strategic philanthropy

Philanthropy is an important aspect of wealth management, comprising philanthropic goals and wealth transfers through charitable giving.

Philanthropic giving is not a one-time event but rather a thoughtful process that can build family relationships, preserve wealth and give back to society. Families that approach philanthropy in a strategic and focused way can make a significant impact, not only for the beneficiaries, but also for the family and the business itself.

Benefits of philanthropic giving

The impact of philanthropy is not limited to the cause itself. Philanthropic giving can benefit your business and family in many ways, including:

- Providing family members with a deeper connection to each other and the outside world
- Giving the family an opportunity to define what it stands for as a group
- Establishing family values
- Creating common ground where multiple generations can share their knowledge, skills, passions and perspective
- Offering opportunities for the current and next generation to develop skills and competencies
- Presenting an emotional and functional bridge between wealth, purpose and society
- Developing, strengthening and perpetuating a legacy for succeeding generations
- Providing a tax-efficient structure for the family and the business.

Questions to consider

- Do you know the advantages of establishing philanthropic goals?
- Have you measured the impact of your giving from a social or environmental perspective?
- How and why should the family engage in philanthropic activities?
- What are the advantages and costs of charitable giving?
- Does your family share a common vision for philanthropy?

How we can help

There are many different channels and important considerations that can enhance your philanthropic giving, including choosing a charity, as well as considering tax consequences, compliance and even the timing of your gifts.

Once you and your family have decided to explore philanthropic giving, KPMG China's family business advisers can help with the possible next steps:

- **Establishing your vision for giving**
  The family needs to establish its philanthropic goals. This may include setting up your own charity or joining others in a like-minded charity.
- **Creating guidelines**
  Once your family has established its vision for giving, you will need to establish a governance structure for your enterprise. Strong guidelines around philanthropy may allow you to concentrate on the philanthropy instead of on resolving disputes.
- **Staying focused on philanthropic impact**
  Choices in charitable giving are focused and strategic. Families should be aware of the tax benefits and implications of giving in today's environment. Commitments should be evaluated on a regular basis and modified accordingly.
- **Measuring your impact**
  It is also important to develop quantitative methodologies for measuring the impact of your giving in a structured way. This can help determine which charities you would like to have relationships with.

Advisers can help develop the family's philanthropic vision, and assist in developing governance guidelines to ensure the giving stays on track with this vision. In addition, impact metrics can be developed to help the family keep track of the effectiveness of their giving.

Fred Tsao

- President, Family Business Network (FBN) Asia
- Board Member, FBN International
- Co-founder and Board Member, Family Business International Foundation
- Chairman, IMC Pan Asia Alliance Group

"Today, we are witnessing the effects of businesses' short-term focus, which may be unsustainable. Multigenerational family businesses have a long-term focus and aim to continue for generations, so they inherently think of relationships in a more sustainable way. By continuously developing, these businesses have the potential to model a longer term focus that can influence society at large about how we think of businesses today. FBN is a community of these businesses which are on a journey of learning and evolution. We need more people with different viewpoints to join in this conversation and collaborate in order to establish a more robust and effective family business ecosystem."

Roger King, PhD

- Adjunct Professor of Finance, Hong Kong University of Science and Technology (HKUST)
- Founder and Director of Tanoto Center for Asian Family Business and Entrepreneurship Studies, HKUST

"China has become more prominent on the world stage. Likewise, family businesses in China and Hong Kong are having a growing impact on the global economy. While they are playing a greater part globally, these Chinese and Hong Kong family businesses are also facing increasing challenges due to generational transition. In Hong Kong, many family businesses are transitioning from the second to the third generation, while in China, family businesses are transitioning from the first to the second generation. Until now, current research in the field of family business has been very Western-oriented. Hence, the models they propose for succession planning within the family may not always be relevant to ethnic Chinese family businesses.

The Tanoto Center for Asian Family Business and Entrepreneurship Studies at HKUST aims to fill the vacuum in the area of family business research and teaching in Asia, and for ethnic Chinese family businesses. We also organise events to bridge the gap between academics and practitioners, and generate practical applications and solutions for Asian and Chinese family businesses. Our centre hopes that these new insights will help Chinese family businesses overcome some of the challenges they face, and we welcome companies like KPMG to join in the conversation and be part of the bridge that connects academia and family businesses."

The KPMG Family Business Blog allows you to connect with us; share our insights, experience and points of view; and discuss what matters to you in the day-to-day running of your business.

Our advisers also have access to KPMG's Global Family Business Centre of Excellence, where they can tap into the expertise of practitioners from around the world.

KPMG Family Business Blog:

http://www.kpmgfamilybusiness.com/china/

KPMG family business regional leaders

Video discussing the KPMG Family Business practice Global Think Tank

Other KPMG Think Tank videos discussing different aspects of family business

Case studies

Communication

Statistical analysis on the US, the UK, Australia and Asia

The latest posts in relation to different aspects of family business

Introduction to the seven specific needs of family businesses

The seven specific needs of family businesses discussed by category

Global – KPMG Family Business

KPMG member firms in numerous countries provide family business advisory services to their clients, including assistance with succession, governance, growth, assurance, exit strategies, wealth preservation and philanthropy.

The dark blue areas on the map show where country leaders can be found, and some of the regional leaders have been highlighted:

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