European Family Business Barometer

Setting the pace for growth

June 2014

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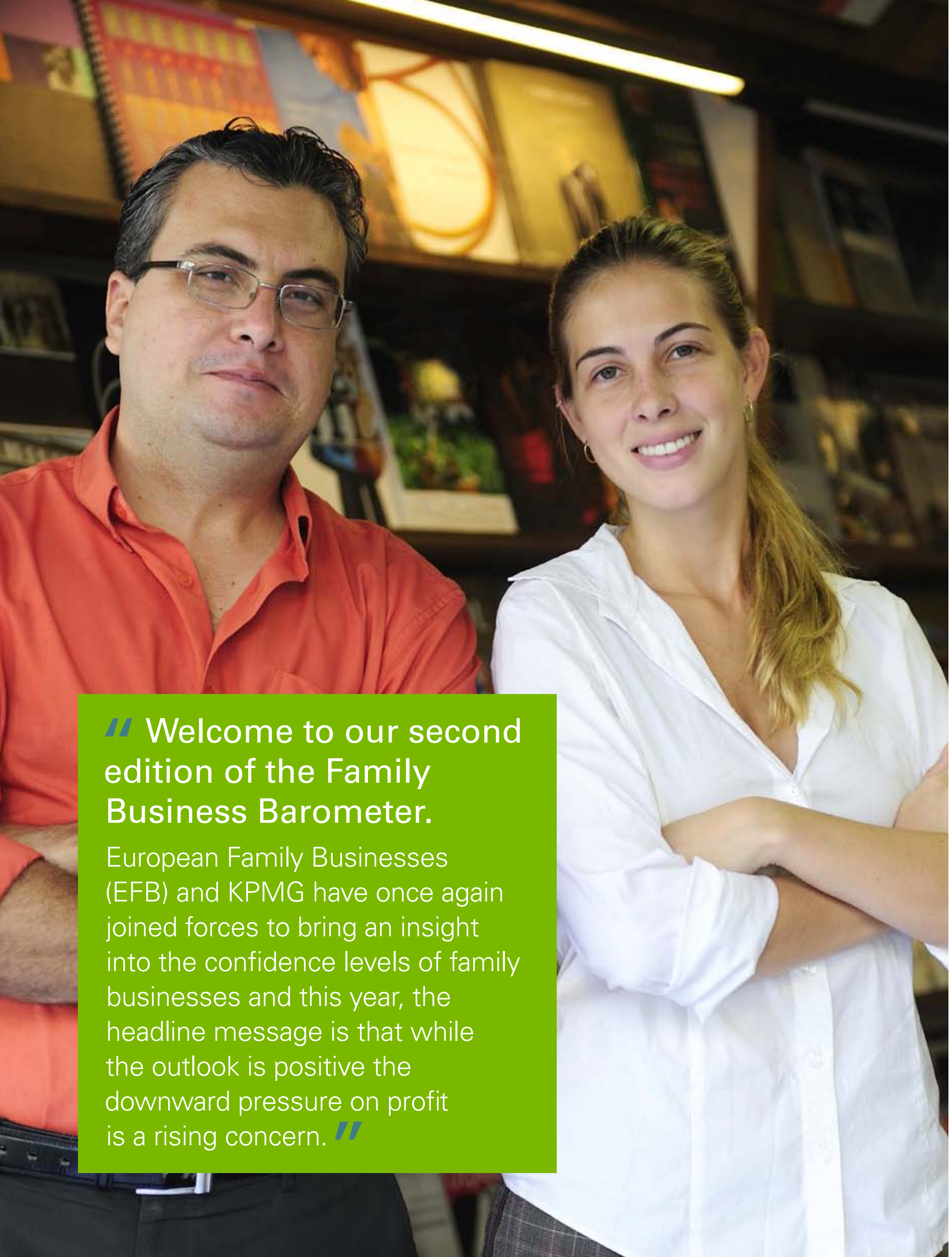
EFB EUROPEAN FAMILY BUSINESSES

KPMG cutting through complexity



"Welcome to our second edition of the Family Business Barometer.

European Family Businesses (EFB) and KPMG have once again joined forces to bring an insight into the confidence levels of family businesses and this year, the headline message is that while the outlook is positive the downward pressure on profit is a rising concern."

Roger Pedder
EFB President

Christophe Bernard
KPMG Global Head of Family Business

Looking to the future

The latest figures from the Eurozone may be predicting restrictive growth figures but for family businesses the future appears bright. In this latest edition of *European Family Business Barometer*, European Family Businesses (EFB) and KPMG once again seek to bring an insight into the confidence levels of family businesses and the challenges that they see affecting their operations.

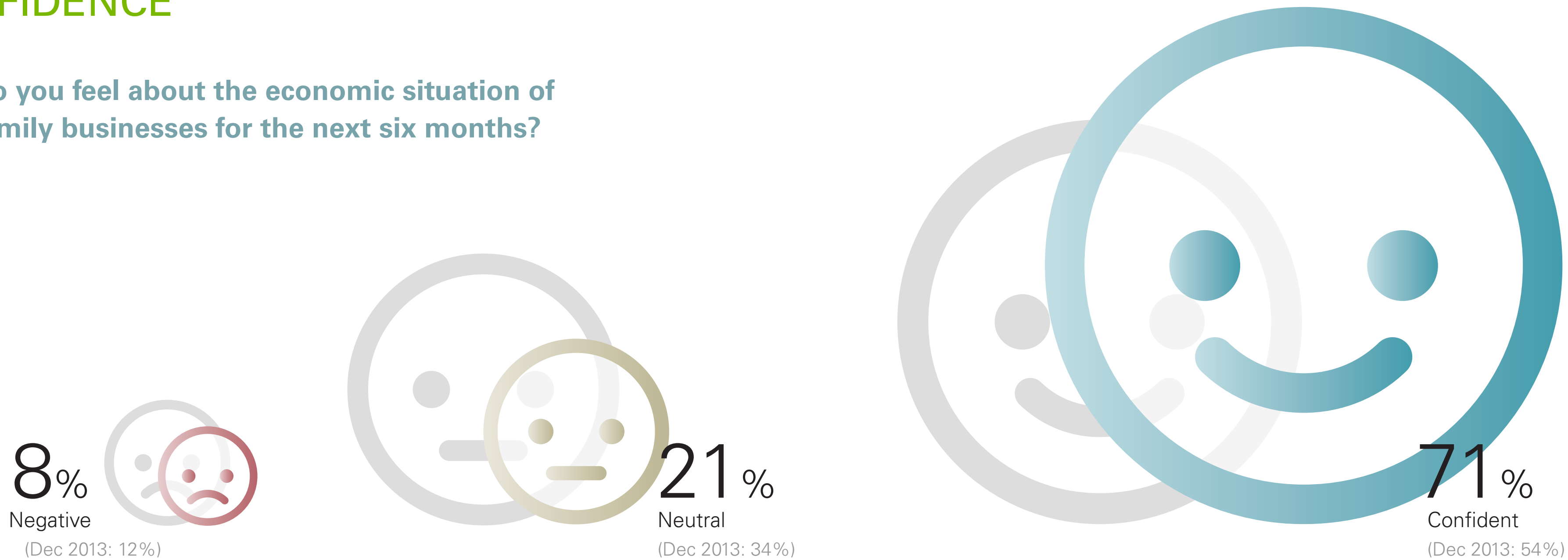
Six months on from our last Barometer and it is pleasing to see that family businesses are becoming increasingly confident in their outlook for the future. There are many positive indicators, not least an increase in those respondents willing to commit to a view of the future as opposed to remaining neutral in their responses. The key message from this Family Business Barometer is that there is a renewed confidence in the markets and ability to seize and fund future opportunities. However, this is to be balanced with an increasing concern around downward pressure on profitability, which respondents have indicated is their key concern for the next six months.

We also see an increased focus on the family element and its influence on business decisions. Family businesses, regardless of their size, appear to be increasingly driven by retaining control of their future growth strategy and are more willing to invest profits for long term reward. This is balanced by an understanding of the impact that good governance structures and communication between generations can have on their future success.

The economic challenge continues, and for some businesses their growth can be hampered, but for the family business, the current environment is bringing new opportunities – for family businesses, the future is bright.

CONFIDENCE

How do you feel about the economic situation of your family businesses for the next six months?



Confidence in market conditions among the family business community is clearly on the rise and visible from the survey results. This year, more respondents have been willing to state their view as positive, as opposed to neutral and for this market segment, all the signs point to market confidence returning even with a war on talent playing out in the background (see page 6).

The results show that 21% of the respondents feel unable to commit to their outlook for the future, a 13% drop compared with December 2013. The most striking contrast however is with those businesses who are confident about their performance in the next six months, with those responding as confident rising from 54% to 71%[1], a double digit swing. So what has initiated this increase in confidence?

Many reasons could be attributed not least the changing funding landscape. A number of respondents have indicated that access to finance and credit is no longer as big a concern as it was six months ago (page 14) and reporting a willingness to re-invest profit and the ability to secure bank funding on the rise. Last year respondents indicated that one of the biggest inhibitors for growth was access to finance with 51% indicating that this had affected their business, a specific challenge being the increase in guarantees required to secure loans.

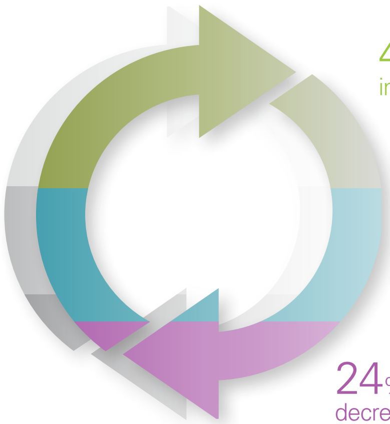
This insight reinforces what KPMG firms and the EFB are hearing among the family business community: that growth is firmly back on the agenda of family businesses.

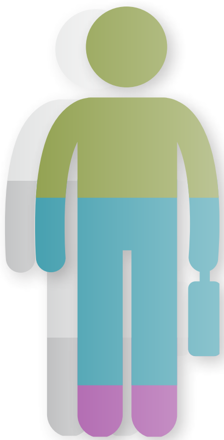
71% of respondents are confident about their performance outlook for the next six months

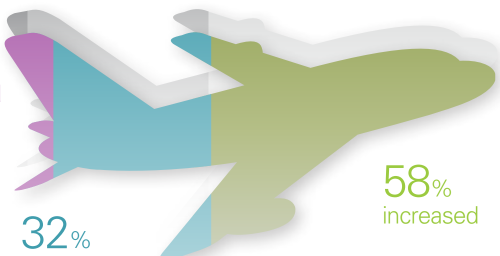
[1] 71% constitutes 10% very confident and 61% confident

CONFIDENCE

In the previous six months your company has:







There has been a noticeable increase in the positive indicators with respect to increasing or maintaining both turnover and staff numbers, with the percentage of businesses indicating a decrease in turnover and staff numbers reducing from 31% to 24%, and 23% to 11% respectively.

Supportive of the confidence levels among family businesses, the figures indicate that while there has been only a small increase in turnover for 44% of respondents (compared to 43% in 2013), the focus on workforce is around maintaining the current position. This could be an indication that some organisations may be going through a period of consolidation, ensuring their business is stable for the next period of growth; especially as 75% of respondents have indicated that they are currently planning strategic investments (page 8).

In the current economic environment the focus is on retaining the workforce, which in some geographies can be seen as bucking the trend, and with 49% of respondents indicating they are maintaining the size of their current workforce, compared with 36% in December 2013 there appears an increased awareness that a skilled appropriate workforce is essential to business success.

For family businesses, growth can come from a number of avenues, not least overseas markets. Of the respondents, 72% indicated that they are engaged in activities abroad, an increase on the 60% registered in December 2013. This however, needs to be balanced with the indication that these businesses have experienced some reduction in their overseas activity during the last six months, a worrying indicator as for many family businesses, international trading often represents an unexploited opportunity.

49% respondents indicated that they are maintaining the size of their current workforce, compared with 36% in December 2013

CHALLENGES AND CONCERNS

What are the major issues facing your family business right now?

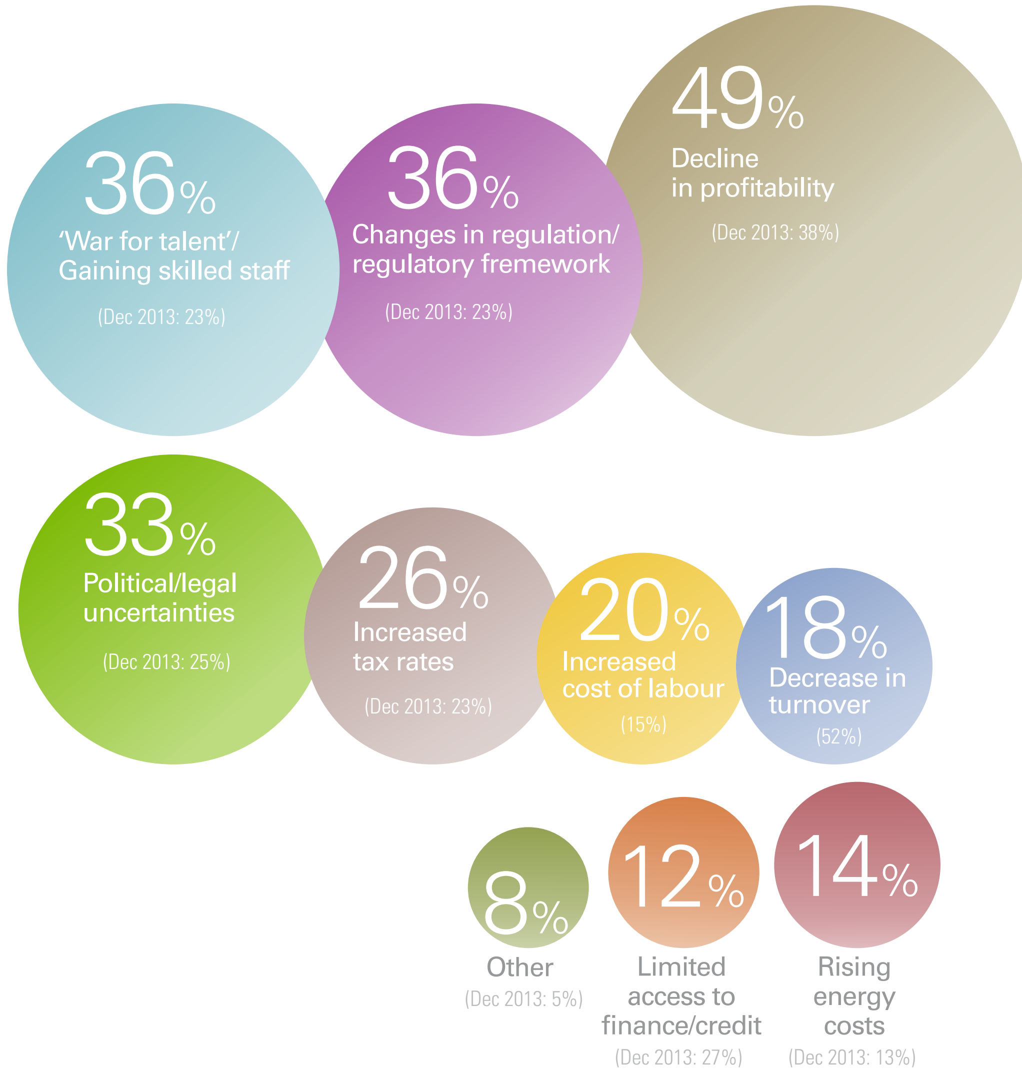
The future for family businesses remains about sustainable growth and while they are confident in the future outlook, the big concerns for respondents is around profitability. Six months ago, the key concern was turnover but it appears that with the market stabilising, the more pressing challenge manifesting is now around profitability. The cost of labour and price point reduction is likely to have had an impact on this.

It is surprising to see the difference that six months can make to the key issues facing family businesses. At present, the top five issues are decline in profitability, changes in regulation/regulatory framework, war on talent, legal/political uncertainties and increased tax rates; compared with six months ago, decline in profitability has increased as a concern with 49% of respondents (compared to 38% in 2013) classifying it as their biggest challenge. Interestingly, war for talent and changes in regulatory framework remain neck and neck albeit both increasing in importance to second in the top five from fifth with a swing from 23% in the last Barometer to 36% in this one. Both declining profitability and the war for talent could be inhibitors for a family businesses growth plan. Declining profits are often accompanied by business decisions which can compromise a platform for growth such as workforce reduction, this in turn could result in the lack of skilled workforce rendering the business struggling to manufacture its products or deliver its services cost effectively. A conundrum which could have a detrimental impact on the business.

> Decline in profitability has increased as a concern with **49%** of respondents classifying it as their biggest challenge

The biggest surprise is how low decreasing turnover ranks with only 18% of respondents seeing it as an issue. Yet another indicator that confidence in the market is truly returning.

The war for talent continues to be a big influencer on future success and has become an increasing trend across the last two Barometers. The warning signs are that attracting the right people with the right skills is becoming an increasing challenge and one which may require intervention if we are to mitigate it having a negative impact on the future of family businesses.



INVESTMENT STRATEGY

Does your strategic plan include any investments or divestments?

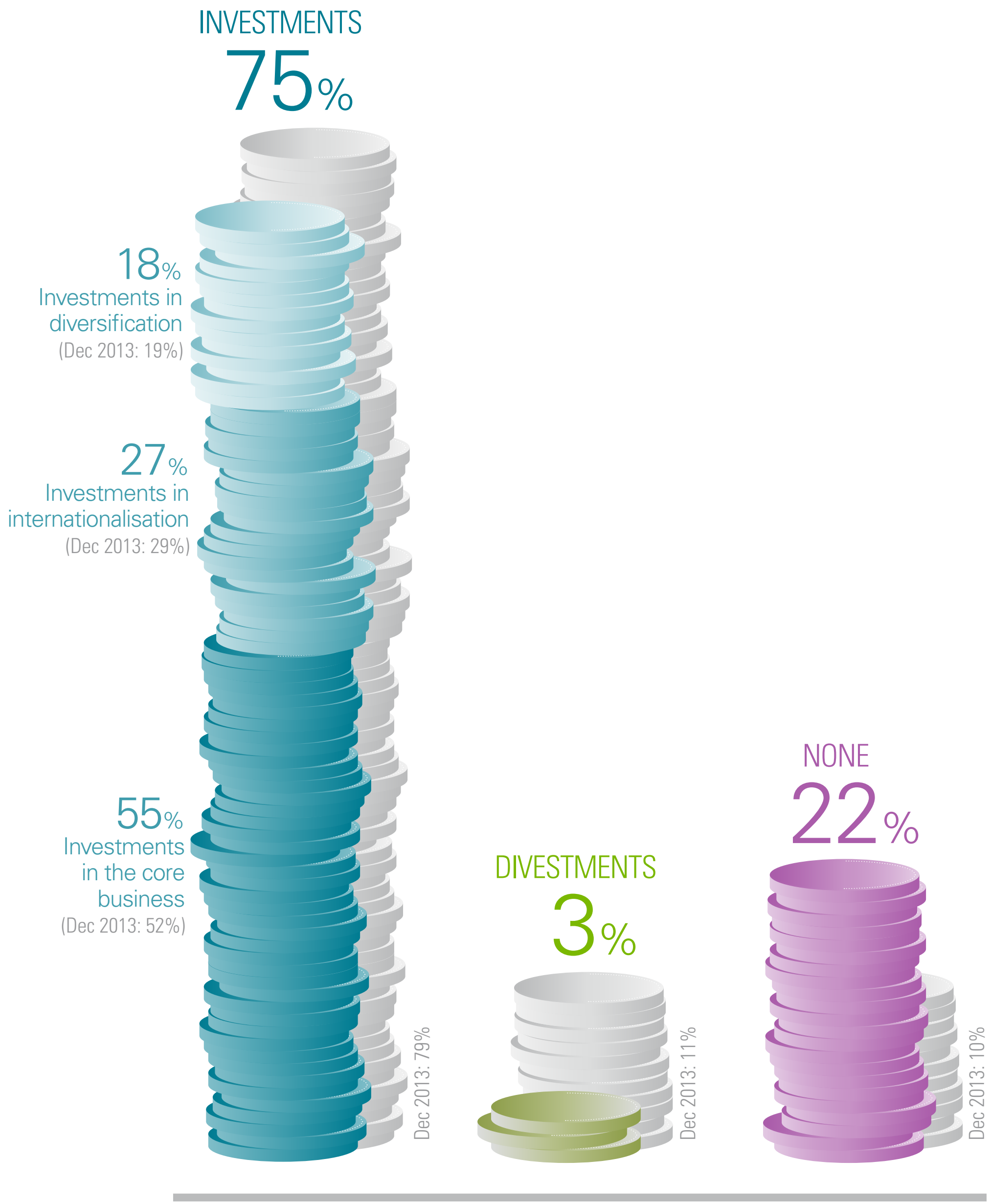
Investment is taking a front seat in the future strategy for family businesses. Of the respondents, 75% are planning investments as part of their strategic plan and only 3% are planning divestments – a large decrease from the 11% reported in December 2013. The trend for investing is yet another indicator that family businesses are preparing for future growth and confident that they are able to realise some return from a re-investment of profit. There is a question as to whether the propensity to invest is a strategy to offset the downward pressure on profit (page 6); i.e. will seeking new markets and looking to diversify will help stem the pressure on profit?

Internationalisation continues to be a largely unexploited opportunity for family businesses and this year we see a 2% decrease in respondents planning to invest in internationalisation, versus 29% six months ago, reflecting a reluctance to fully embrace the opportunities of foreign markets.

There has been an increase in investments planned for the core business, from 52% to 55%.

Successful businesses will ensure that their investment strategy does not expose them to future risk so avoiding a single approach and adopting a strategy which involves a mix of investment routes is deemed to be a robust business strategy but internationalisation could still have a more pivotal role in future growth.

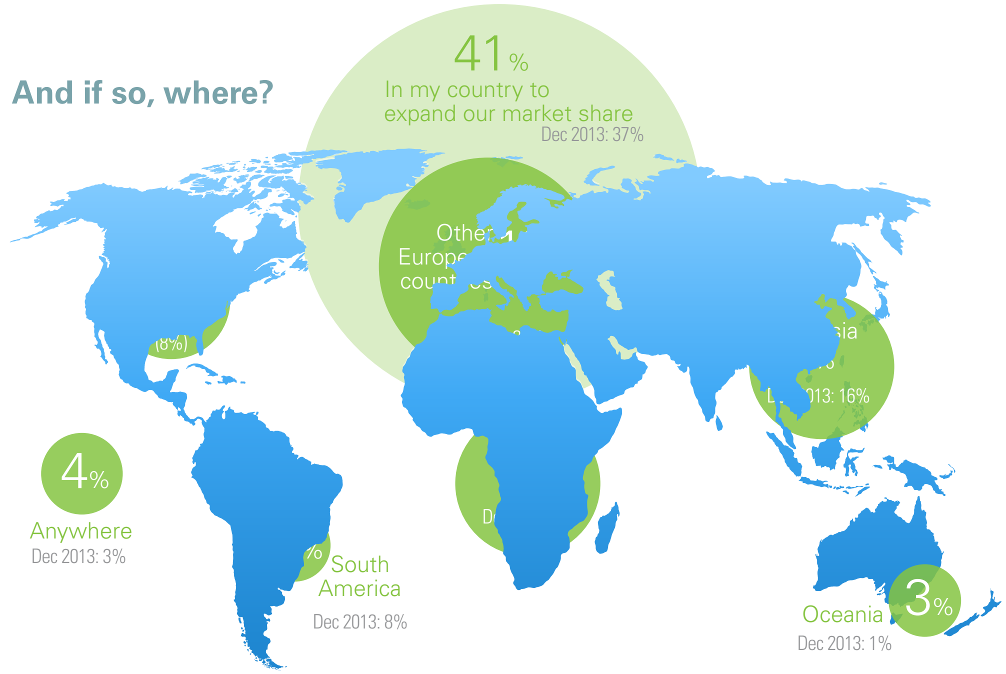
> **75%** of respondents are planning investments, with over half of them investing in the core business



INVESTMENT STRATEGY

Are you thinking about investment opportunities?

And if so, where?



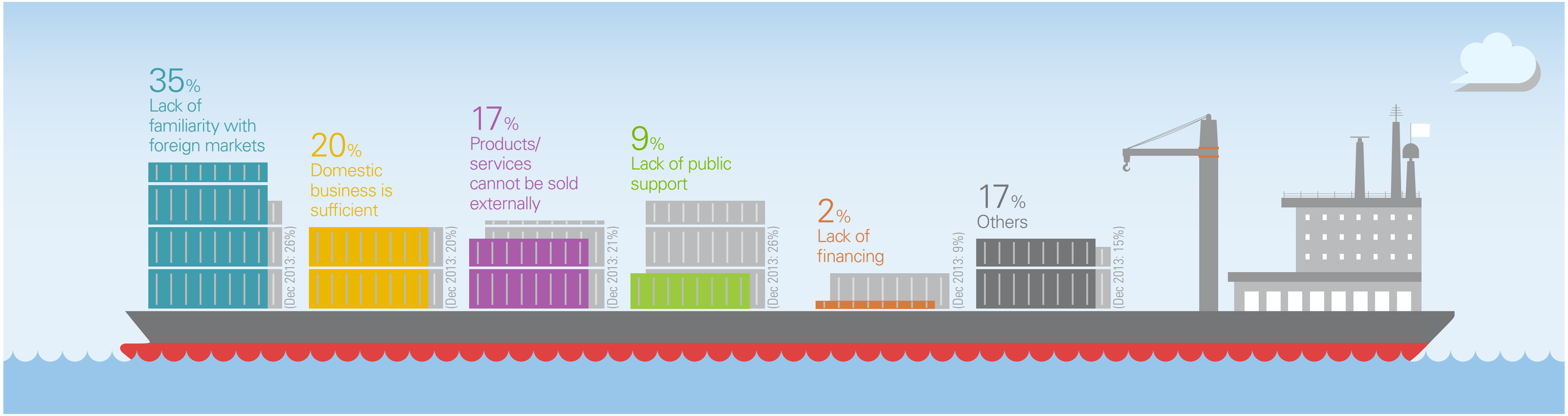
With 75% of respondents considering future investments, it is surprising to see that only 27% (page 8) are looking to embrace internationalisation, the reasons for which have been briefly considered overleaf. The majority of investments taking place appear to be in markets where there is an element of familiarity. A total of 41% of respondents, an increase of 4% on last year, have indicated that their investments will be in their home country and 19% in other European countries; it appears that familiarity with markets mitigates risks associated with the investment.

Where internationalisation is taking place, it is interesting to see the change in countries that are currently deemed most attractive; both Africa and Oceania have increased in attractiveness from 7% to 11% and 1% to 3% respectively.

11% of respondents are considering investing in Africa, up from 7% six months ago

INVESTMENT STRATEGY

Why doesn't your family business sell to foreign markets?



The investment landscape paints an interesting picture. Over the last six months respondents indicated a decrease in undertaking activities abroad (page 10) and of the 75% considering future investments, only 27% were considering internationalisation (page 8), resulting in the opportunity for growth from internationalisation remaining largely untapped.

While markets abroad offer a growth opportunity, 40% of respondents are still not engaged with foreign markets and 35% of this group attribute their decision not to engage or invest in foreign markets to a lack of familiarity. The huge potential for growth that exists is being missed and potentially inhibiting a business from realising its full potential. On a positive note, only 2% of respondents indicated that the decisions not to sell to foreign markets was due to funding.

The trend for not investing in foreign markets, is not reflective of the family businesses attitude towards or willingness to invest; there has been an increase this year in the percentage of those businesses planning investments albeit in domestic or European destinations. There is also a trend towards divestment decreasing.

35% of those not planning investments in foreign markets attribute it to lack of familiarity with international markets

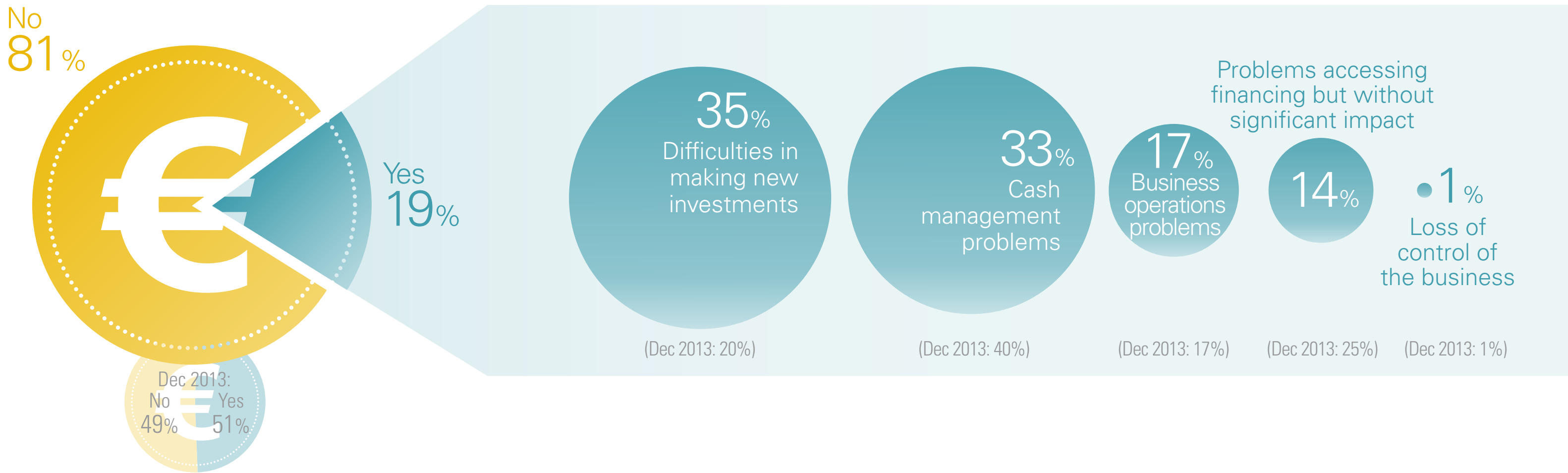
ACCESS TO FINANCE

In the last six months, has your family business experienced difficulties in accessing finance?

Access to finance has been mooted as a key issue and growth inhibitor for many businesses in the current environment not least family businesses. It is pleasing to see that in the latest results, the outlook for securing finance has stabilised with 81% (compared to 51% six months ago) indicating that it is not an issue. So what has changed for family businesses?

A small proportion of respondents, 19% compared to 49% six months ago, have indicated that they are still experiencing difficulties accessing finance. The impact of this challenge appears to be firmly focused on making new investments difficult with 35% of respondents affected indicating this as their key challenge.

It appears that while access to finance is improving, it is not manifesting across the board with almost a fifth of family businesses still being affected.



81% of respondents see access to finance as no longer being an issue

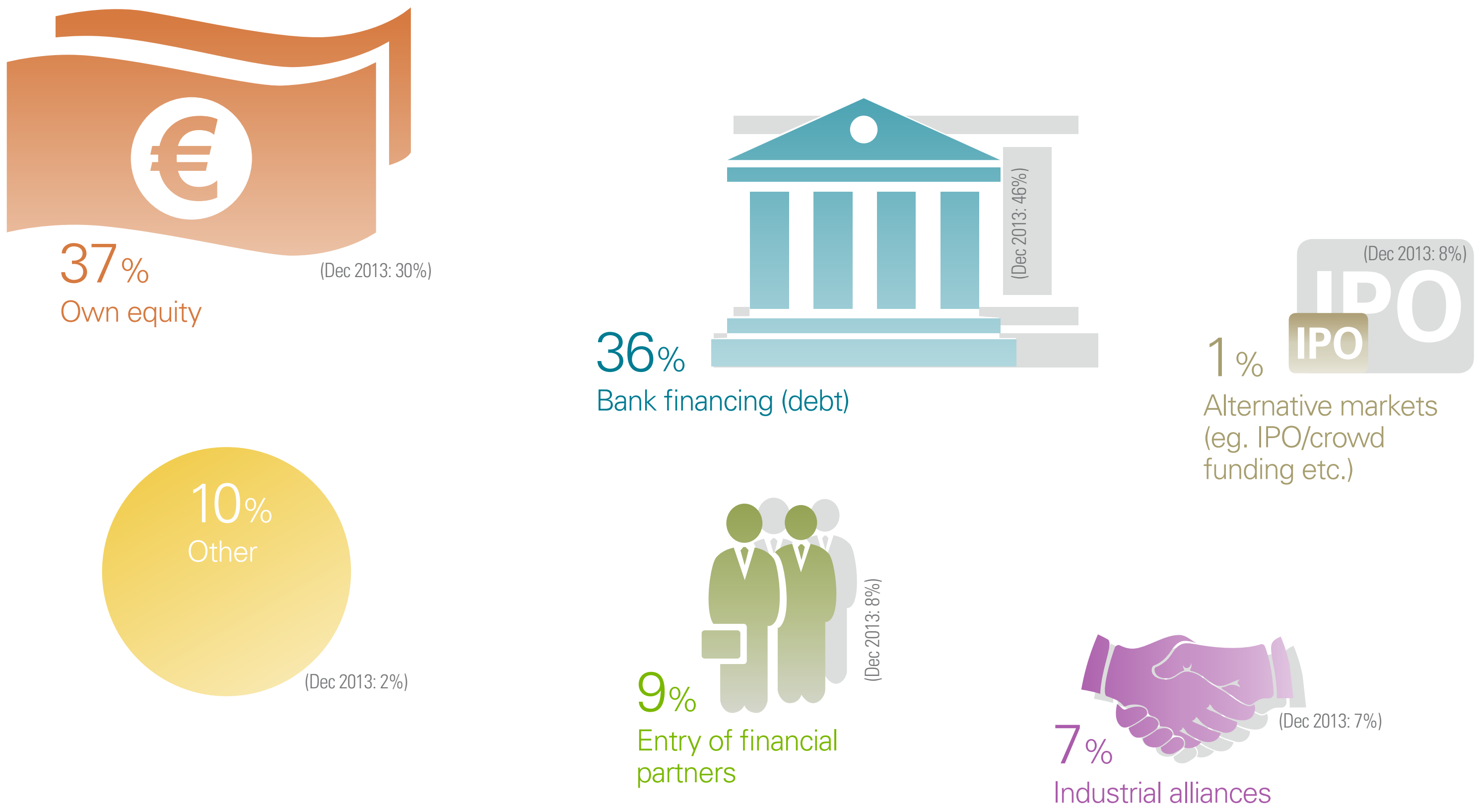
FINANCING

Regarding financing, which of the following options do you consider the most attractive in the next six months?

In a change from last year, the results indicate that family businesses are now increasingly using their own equity to finance business growth, once again indicating a strong confidence in the future and willingness to re-invest profit – a long-term commitment with long-term rewards. This can be an indicator in an increasing confidence in the returns from the business or an increasing desire to remain independent and in charge of their future. In fact private ownership is attributed as one of the key strengths and influencers on a family businesses success (page 20).

> Family businesses are using their own equity to fund their business growth

It is important to note that traditional forms of financing remain the most popular with the use of their own equity and bank financing coming out as the most attractive routes at 37% and 36% respectively.



REGULATORY ENVIRONMENT

What changes/improvements would you welcome most?

In the recent EFB/KPMG *Tax Monitor* survey, the regulatory framework features quite heavily in the results. Family businesses want a stable predictable framework that they can operate with where simpler rules govern operation. Simpler tax rules once again came out as the improvement that would be most welcomed with 52% of respondents ranking it in their top three.

Family businesses perceive a key challenge as being inter-generational family business transfers specifically the tax treatment and financial burden that this may bring. A total of 45% of respondents indicated that they would like to see concessional tax arrangements for inter-generational family business transfers, a rise on 30% from last year. Family businesses are looking for a simplification of the rules and a ‘fairness’ to the approach.

In our recent *Tax Monitor* survey, the range of taxes applicable to family businesses and their stakeholders mean the possible impacts and complexities of tax regimes across Europe are magnified. The study found that the overall burden of taxation on succession, even for the most simple of family businesses, on inheritance or retirement, can vary significantly dependant on the country of operation. Yet more complexity for family businesses.

52% of respondents call for simpler tax rules

FAMILY BUSINESS STRATEGY

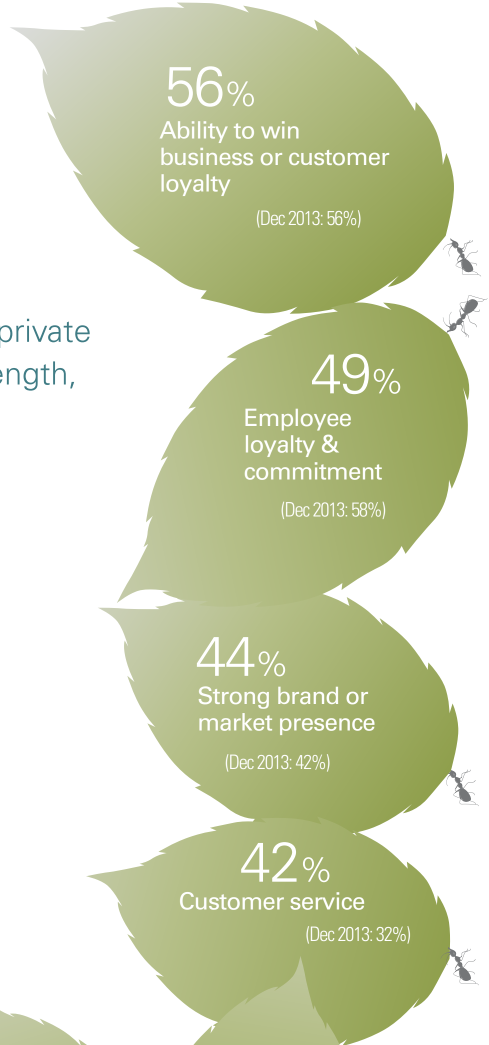
What would you consider to be the top 5 key strengths of your business?

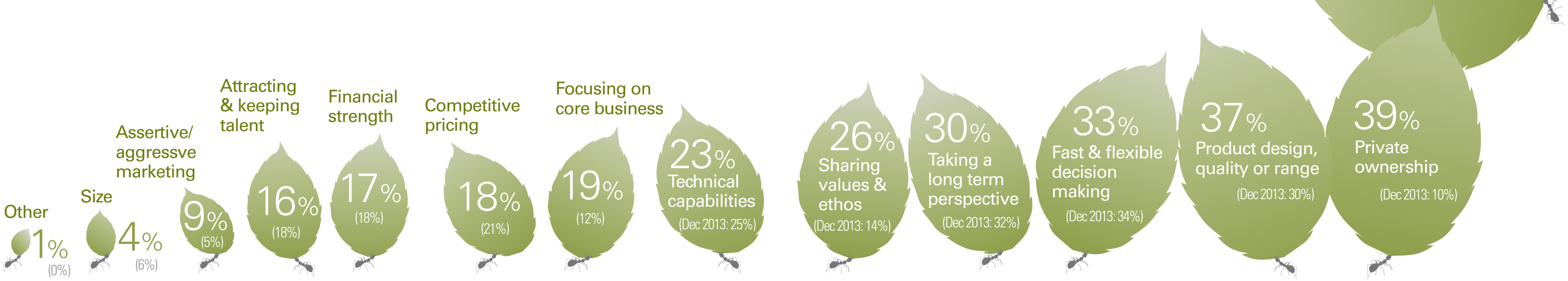
The past few years may have been challenging but family businesses remain clear as to what drives their success – people, clients and markets. The ability to win business or customer loyalty remains a top priority followed closely by employee loyalty, brand and market presence, and customer service. The rising importance of the family element is indicated by the increased importance placed on private ownership and shared values and ethos.

This year, the survey results indicate a large swing in those survey participants that believe private ownership is one of their key strengths with it increasing in importance from 10% to 39% putting it firmly in the top five. So what makes private ownership a key strength?

Maintaining family control of the business is regularly weighted highly important to the family business community. The ability to map out and be responsible for their strategic direction and future growth is one of the elements that drive this community (page 22). Being in control of the business enables them to ensure their strategy is focused on protecting their people, embedding relationships and securing loyalty from clients and being flexible enough to respond to changing market conditions.

39% of participants believe private ownership is a key strength, up from just 10% six months ago





THE FUTURE FOR FAMILY BUSINESS

Importance of family issues for the business

Family businesses are driven not only by market conditions but also a series of critical success factors. These businesses recognise that whilst control of the business is important to them and has an influence on their success, the need for good governance structures is just as important. In this survey, we have seen that maintaining control of the family business, good governance structures and communication between generations continue to rise in importance as influencers. It appears that respondents attribute much of their success to the increasing involvement and influence of family factors.

> **87%** of businesses indicated that maintaining control is a key success factor

Critical success factors may be subjective in the context of the family business but with 87% indicating that maintaining family control of the business is one of their key success factors, the influence of family values on the business is hard to ignore. In the current environment, some would question how a business can fully reach its potential if family led but with 86% recognising that good governance structures and processes are also key contributors, it is easy to see that these businesses have a good handle on the need for a strong business focused framework in order to realise their full potential.

When comparing the results of this survey with the previous, some interesting trends begin to appear. Family issues increasing in importance include communication between generations which has increased from 63% to 85%; balancing family concerns and business interests has increased from 59% to 81%; and informing family of business issues has increased from 53% to 73%. In each case, a relatively large swing in percentage can be seen.

Family businesses still clearly enjoy the freedom to carve out their own future success but this often comes at a price. The willingness to re-invest in the business for long term reward (page 16) can be seen as an indication that the family business of today is confident in its future success but also acknowledges that where the business is run by the family, it can't be achieved by one family member alone.

FAMILY BUSINESS STRATEGY

Are you considering any options for your family business over the next 12 months?

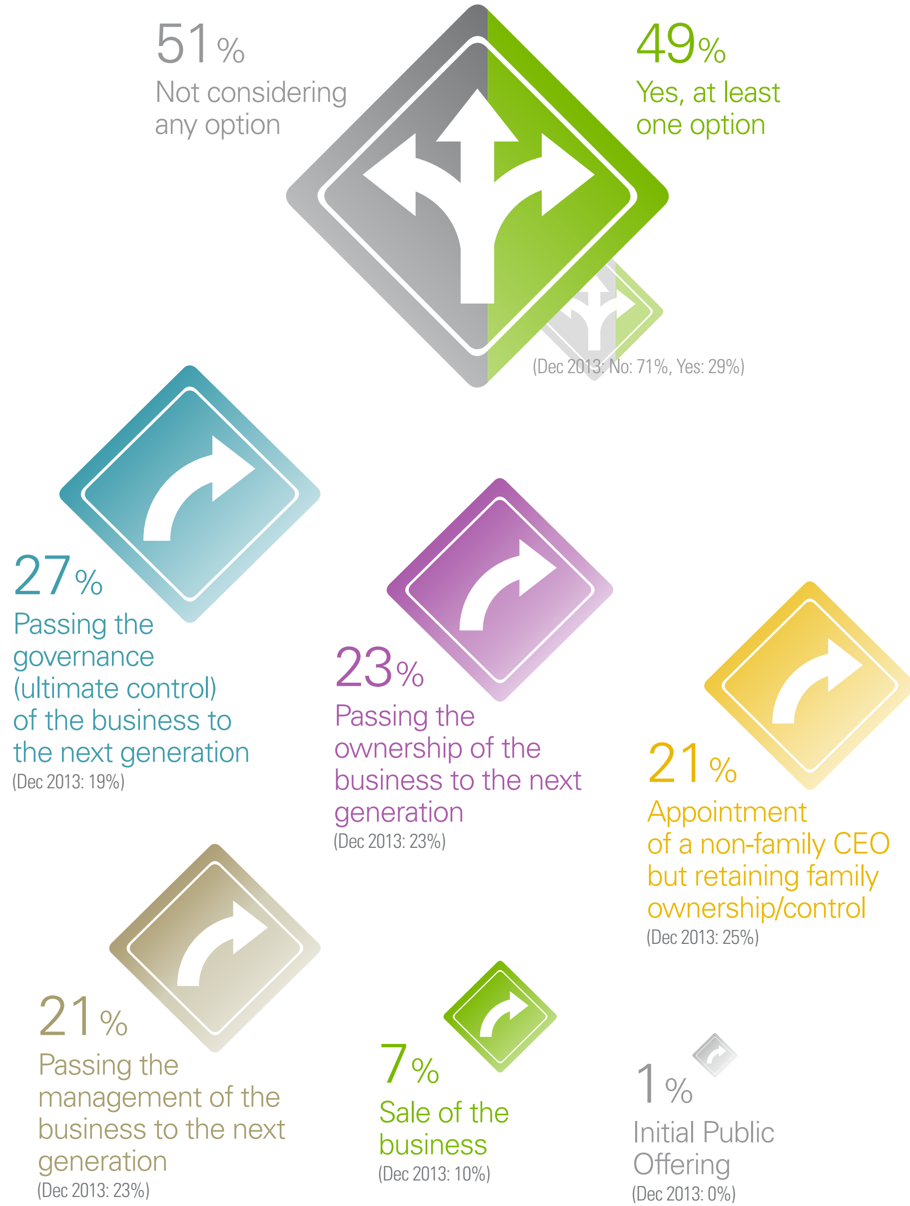
Family businesses are increasingly looking at their future and the strategy behind next generation transfer has increased in importance this year with 49% of respondents indicating that they are considering a strategic change in the business operation during the next 12 months. Of the options given, it is refreshing to see that only 7% of this group are considering a sale of the business with the remaining 93% planning on keeping it in the family.

The highlights are: 27% plan to pass on control/governance; 23% will be transferring ownership; 21% are to pass on management of the business; and 21% will seek to appoint a non-family CEO but retain control within the family.

The results are naturally subjective and based on where the business is in its lifecycle and will also be influenced by the generational profile of the family members controlling the business.

The increase in businesses considering these options still represents a big increase on six months ago when only 29% were looking to these as their next steps.

49% of respondents are considering strategic change



METHODOLOGY

The European Family Business Barometer is based on the results of an online survey. In total 710 completed questionnaires were received from EFB members during the period 31 March 2014 to 4 May 2014.

This is the second survey of its type to be conducted measuring trends among family businesses.

The responses from the following countries have been analysed:

- Austria
- Bulgaria
- Cyprus
- Finland
- France
- Germany
- Greece
- Hungary
- Ireland
- Luxembourg
- Malta
- Poland
- Portugal
- Slovakia
- Slovenia
- Spain
- The Netherlands
- UK

We trust that you have found these results an insightful look into the family business community. We look forward to bringing you an update on the trends of family businesses in December 2014. We hope that you will continue to contribute to our survey.

Roger Pedder

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EFB President

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