Family businesses in the digital economy

Foreword

Family businesses, often understood as businesses managed by more than one member of a single or few "dominant" families[1], are the foundation and engine of many economies in Asia. Some of the more successful family businesses have become large multinational conglomerates and established household names in the region.

The rapidly evolving digital economy, technology changes and forces of globalisation promise to have far-reaching consequences on the business models of the typical family business in Singapore.

In this study undertaken by KPMG with the support of Converging Knowledge, our survey suggests that digitalisation and innovation are two of the top three concerns keeping family businesses awake at night.

With the advent of emerging technologies like virtual/augmented reality, robotics, 3D printing and internet of things, family businesses are increasingly beset by new challenges in addition to the often discussed ones such as succession planning and governance.

This pace of technological change is also accelerating; it is expected to continue redefining industries and creating new ones from scratch. Business model transformations that once took 10 to 20 years are now happening in as few as two to five.

These new technologies already have a highly disruptive impact, transforming business practices and even the world as we know it. But collectively, they also herald in the fourth industrial revolution, also called Industry 4.0.

Many of family businesses are struggling to keep pace. Family businesses surveyed were unclear to the potential of digitalisation as a means to transform existing business models. Digitalisation was often limited to deploying information systems and manufacturing processes, or e-commerce.

I hope you find this report informative, as the second in a series exploring how family businesses in Singapore are coping with many of the issues they face, ranging from business disruption and digitalisation to governance and succession.

Chiu Wu Hong
Head of Tax and
Head of Enterprise

[1] Our research indicates that whether a company considers itself a family business is largely subjective, and there is no one single definition of a family business. As such, the prequalification criterion for our sample, and this study, is based on the perspectives of the business owner, or executives, i.e. if they see themselves as a family business.

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Contents

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Executive Summary

Opportunities abound in this era of hyper connectivity brought about by rapid digital evolution. Over the last few years, the digital economy has grown exponentially and the potential for growth is tremendous.

In ASEAN alone, the digital economy has the potential of growing to US$200 billion by 2025[2]. Research by MIT Sloan shows that companies who adapt to a digital world are 26 percent more profitable than their industry peers[3].

Studies have shown that family-owned firms outperform their non-family counterparts in terms of sales, profits, and other growth measures. Yet, in so many ways, the survival of the family-owned business models as we know it is under greater threat than ever before.

Previously steered by deep-rooted values, family businesses today have to balance traditional business models with the need to confront business disruption to thrive in a future economy. In addition, family businesses are also challenged to address the digitalisation megatrend that may disrupt their businesses across sectors globally.

But while organisations are keen to "get ahead of the curve" on digital, they are not guided by any instruction manuals on how to deliver a successful digital transformation.

In part, this could inherently be due to how they are organised.

For instance, family businesses tend to have longer-serving CEOs. Many family businesses have their CEOs for over 15 years, sometimes even up to 25 years[4]. In contrast, the average tenure of CEOs in publicly owned firms is six years[5]. Such extended tenures may contribute to the difficulties of family businesses in coping with seismic shifts in technology, business models, and even consumer behaviours[6].

[2] https://www.gov.sg/microsites/future-economy/press-room/news/content/the-future-is-digital#sthash.7shGYxm5.dpuf
[3] https://hbr.org/2016/03/the-4-things-it-takes-to-succeed-in-the-digital-economy
[4] https://hbr.org/2012/01/avoid-the-traps-that-can-destroy-family-businesses
[5] http://business.asiaone.com/news/long-serving-ceos-how-long-too-long
[6] https://hbr.org/2012/01/avoid-the-traps-that-can-destroy-family-

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Executive Summary

On Digitalisation

64%
said that digitalisation is a top concern.

75%
agree that there is a need for digitalisation but they may not fully understand the significance or its possible benefits given limited understanding of digitalisation.

Among family businesses that see a need to digitalise their businesses, **63%** cited lack of expertise and skills needed to develop and implement a digitalisation strategy.

On Innovation

Newly established family businesses are not necessarily more **innovative** than more established ones.

Innovation in family businesses tends to occur primarily at the management level **(66%)**, and many do not see the need to engage with staff or business partners in innovation.

Family businesses consider the lack of an internal culture for innovation as a significant barrier to innovation **(24%)**.

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Challenges for family businesses

With rapid changes in commerce and technology, family businesses are faced with new sets of issues and challenges. The study considers how family businesses are approaching the application of technology in their business, and also looks at their attitudes to innovation.

According to our survey, family businesses see digitalisation, innovation and manpower as the top three concerns.

Approximately 64 percent indicate digitalisation as a current top concern. It is interesting to note that while 54 percent of family-run businesses in our sample do have a strategy in place to address this, it nevertheless remains a top concern (Figure 1). A third of respondents do not have a strategy to address this at all.

Family businesses tend to have a "closed" ecosystem for generating new ideas, centralised amongst key individuals.

Most family businesses considered "innovation" as conceptualising and introducing new products, services or business models. Yet, 40 percent said they have not been able to come up with new or improved offerings for their market (Figure 7).

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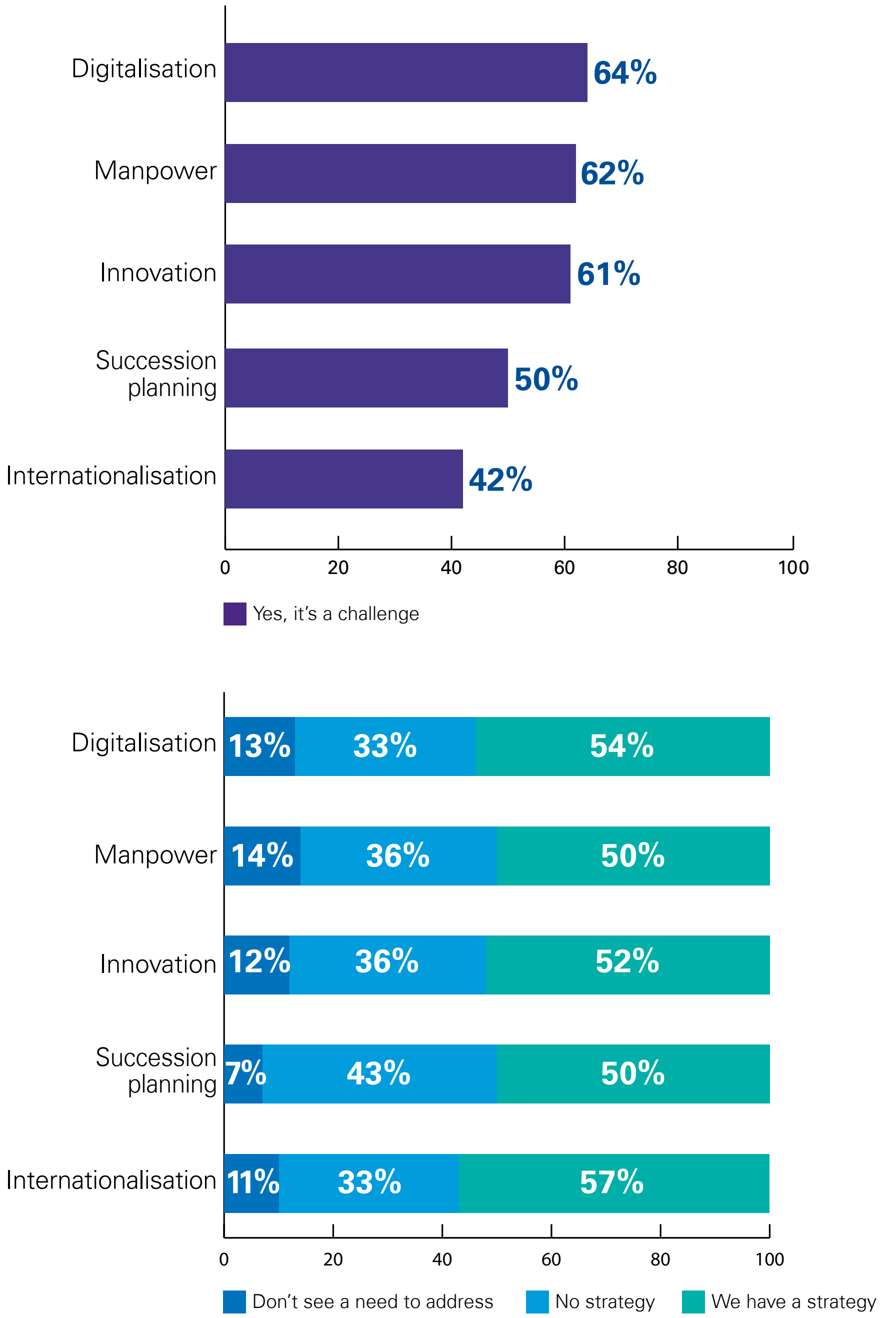
Figure 1: Main challenges for a family business



Base: All respondents (N=100)

Digitalisation is the main challenge for most sectors, with the exception of the engineering industry (45 percent) and manufacturing companies (52 percent). Innovation ranks the second highest concern across sectors, particularly for Information and Communications Technology.

Among:

- Media & Entertainment (60 percent)
- F&B Hospitality & Recreation (75 percent)
- Wholesale & Retail Trade (67 percent)
- Transportation & Storage (70 percent)
- Manufacturing (67 percent), and
- Professional Services (50 percent).

Overall, at least 60 percent of the respondents in this study are currently facing this issue. The need to differentiate themselves amid high competition in these sectors could have driven the need for innovation.

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PART I: Digitalisation

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The need for digitalisation

Digitalisation is a megatrend that is expected to have far-reaching consequences on how businesses is conducted.

In this study, digitalisation refers to the adoption or increase in use of digital or computer technology to transform the business or improve its performance. Almost all family businesses are aware of this megatrend, with only 25 percent of respondents indicating that they do not see a need to digitalise their business (See Figure 3).

However, the business potential for digital transformation is not well understood. Most family businesses in this study (70 percent) think of digitalisation as e-commerce or online business transactions, while 59 percent regard digitalisation as a platform to engage customers.

A smaller proportion (44 percent) sees digitalisation as a more holistic process of applying data analytics as shown in Figure 2.

More than half of the 25 percent of respondents who do not see the need to digitalise see it as not being relevant to a business of their type, size and scale. About 32 percent of the companies are consumed by their day-to-day operations, and 24 percent opined that their current non-digitalised processes would be sufficient to see their businesses through to the future.

Figure 2: Respondents' views on Digitalisation

Business transaction / E-commerce / Provision of online services

70%

Customer engagement in digital platforms (e.g. social media and online communities

59%

Application of data analytics

44%

Converting analog into digital information (such as storing and transmitting consumers' information electronically)

1%

Note: Respondents may choose more than one option.

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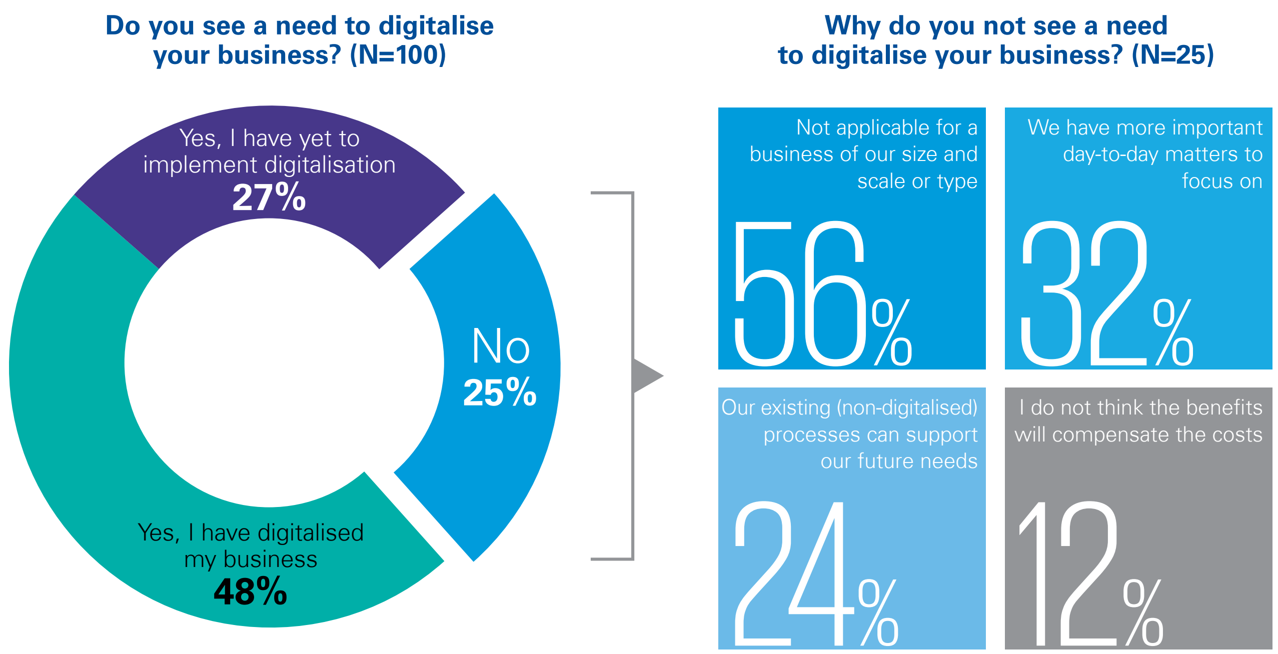
Figure 3: Respondents' views on the need for digitalisation



Note: Figures may not add up to 100 percent due to rounding.

Those family businesses that do not see a need to digitalise their operations are mostly in the Manufacturing (28 percent), Engineering (20 percent), and Wholesale & Retail Trade (20 percent) sectors.

For those who saw the need to digitalise their business, 64 percent have already started on or completed the process of digitalisation, while another 36 percent are still in the planning stages.

Among those who have digitalised their business, 58 percent of those respondents did so because they can and have seen how digitalisation can benefit their businesses. The drive to digitalise tends to be driven by a company's directors and shareholders with more than half (54 percent) of the respondents choosing this option. The impetus was less likely to come from external forces, with only about 44 percent of such respondents choosing clients and suppliers.

For companies that have yet to implement digitalisation, the need to digitalise the business is driven significantly by competition (70 percent), in order to stay ahead of the game.

Details of the need for digitalisation are shown in Figure 4.

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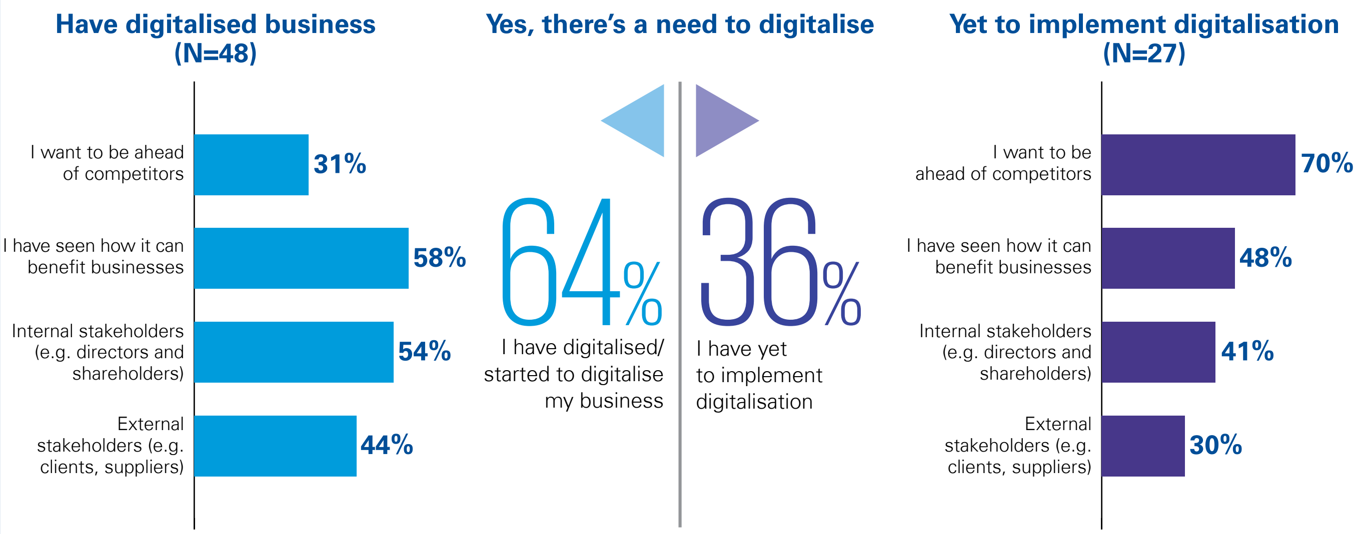
Figure 4: Proportion of companies who see a need to digitalise their business



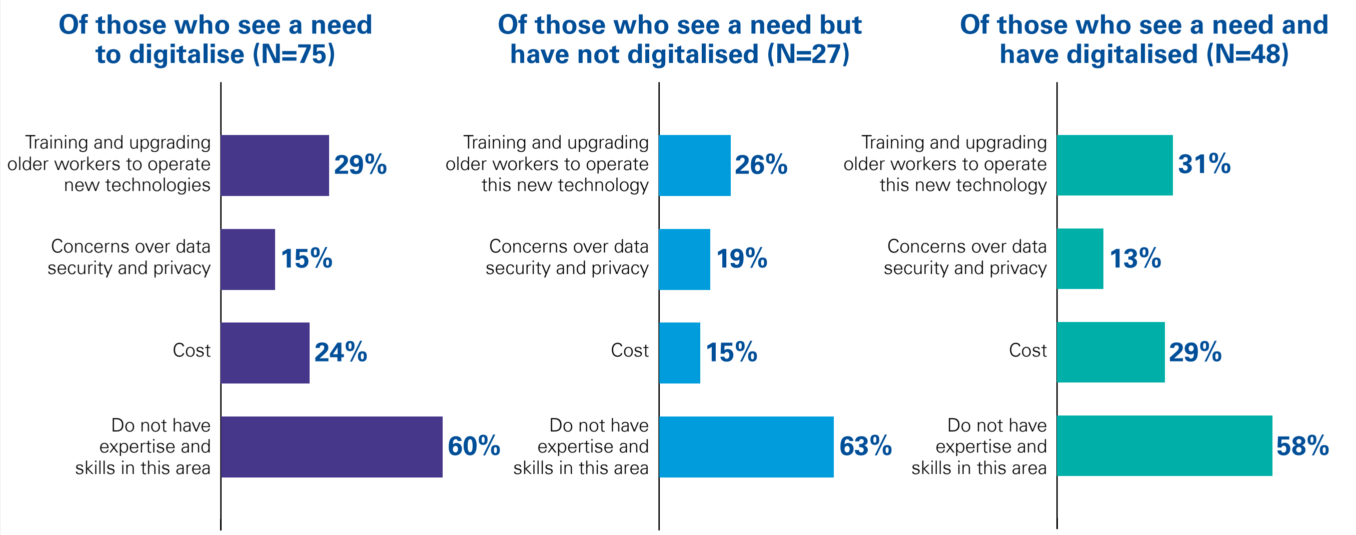
Base: Those who see a need to digitalise (N=75)

This study found that the lack in relevant expertise and skills and training/ upgrading for older workers continue to be the top two challenges for both groups of respondents.

The primary challenge was cited as a shortage of expertise and skills, indicated by some 63 percent of respondents as their topmost challenge. The ability to upgrade older workers to operate new technologies (26 percent) and the concerns over data security and privacy (about 19 percent) were also pertinent.

For those who have already digitalised their business, cost was the third key challenge during the process. However, those who have yet to go ahead with digitalisation regard data security and privacy as a more pressing issue over cost.

Figure 5: Challenges faced by respondents who see a need to digitalise



Note: Respondents may choose more than one option.

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Solving Digitalisation issues

Clearly, obtaining external help prevailed among those thinking about digitalisation. Among those which have digitalised their business, a majority or 63 percent solved their digitalisation issues by engaging external consultants.

Among those with such plans, 72 percent of the respondents have hired or are intending to hire an internal team of experts or external consultants to resolve their digitalisation challenges.

For those who have not digitalised their business, **almost 60 percent would hire a team or engage external consultants to assist if they planned to digitalise.**

While 75 percent of respondents see the need to "digitalise", less than 50 percent of respondents have realised the full potential of digitalisation by leveraging analytics and deploying a digital strategy. This seems to be due to a lack of understanding of what digitalisation means for family businesses.

The majority of family businesses surveyed view digitalisation as the use of e-commerce for online transactions, or (using Internet 3.0) to engage customers online. Hence, family businesses may not be aware of the real benefits of digitalisation for their businesses.

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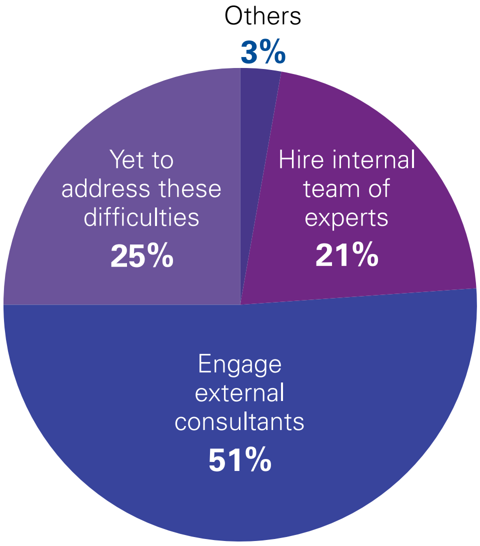
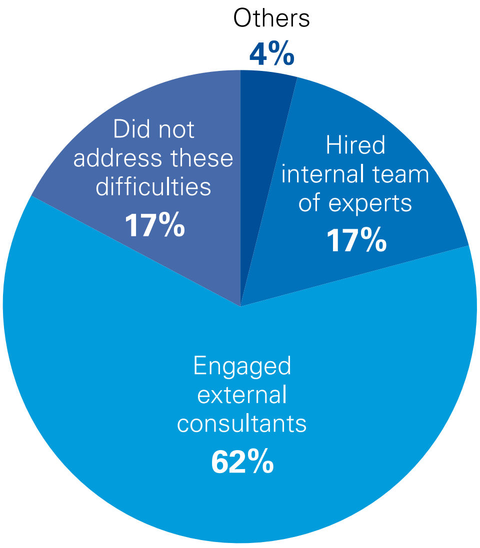
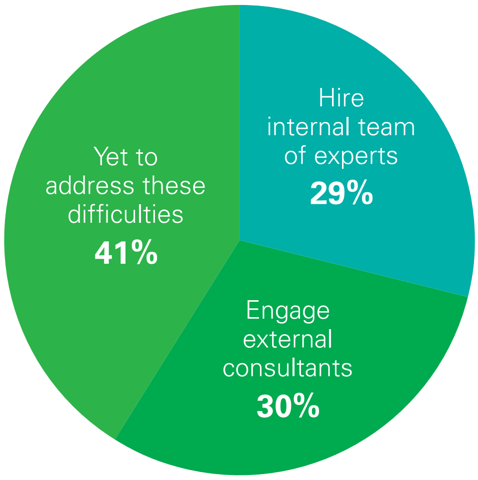
Figure 6: How these challenges were/will be solved



Base: Those who see a need to digitalise (N=75)



Base: Those who have implemented digitalisation (N=48)



Base: Those who have yet to implement digitalisation (N=27)

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PART II: Innovation

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The challenges in innovation

KPMG's 2016 Global CEO Outlook found that a significant majority (77 percent) say it is important to specifically include innovation in their business strategy, with clear targets and objectives. Yet, 86 percent of CEOs globally said they lack time to think strategically about how innovation can shape their company's future.

The approach to innovation in many companies worldwide has often been haphazard, with little attention to fostering an innovation culture. Innovation also tends to be siloed in most organisations.

In our study, we found that **66 percent of respondents said that innovation takes place within the management team.** Many family businesses therefore tend to have a "closed" ecosystem, where idea generation is centralised amongst key individuals.

More than half (53 percent) of family businesses do not have any existing plan to inculcate the culture of innovation. Only 25 percent of family businesses actively encourage employees to try out new ideas and challenge the status quo.

And, family businesses are sometimes vulnerable to inertia, with the senior management (often the family members) emotionally tied to a single product or a specific way of doing business. Founders, in their desires to leave a longer lasting legacy, may become even more conservative when it comes to new ideas. These factors may make it more challenging for innovative ideas to take root and grow in a family business.

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Types and sources of innovation activities

While close to half of the companies interviewed have been making improvements in their products and services, another 40 percent said they have not been able to come up with new or improved offerings into their market.

Younger firms as compared to older businesses

Majority of the companies lack a culture of innovation, regardless of their years of establishment. **Therefore, younger family businesses are not necessarily geared towards innovation.**

The common innovation initiative among respondents is improvement in their existing products (see Figure 9). Family businesses that have been operating for more than 10 years (i.e. more established companies) are more likely to have successfully introduced products and services that are entirely new to the market, match competitors' offerings, or have made improvements to their existing products and services.

Further findings also revealed that such accomplishment is strongly influenced by the management team (see Figure 10). More established family businesses are also more likely to tap on a wider variety of innovation sources, including external sources like government agencies and research institutes.

Regardless of the revenue size of companies, companies generally encourage employees to try out new ideas, and challenge the existing state of their business.

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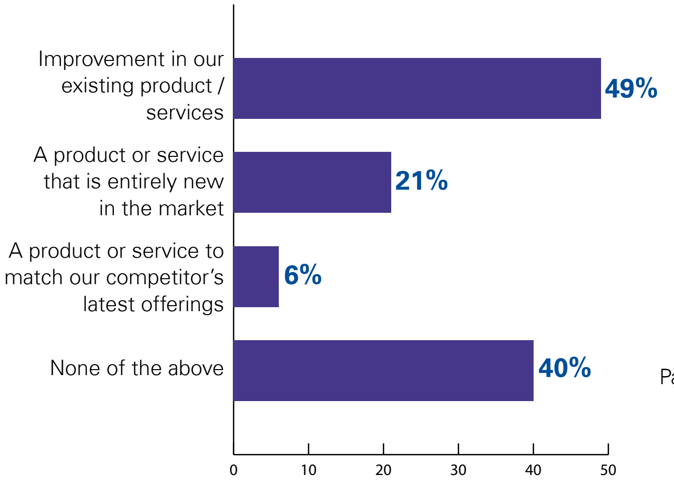
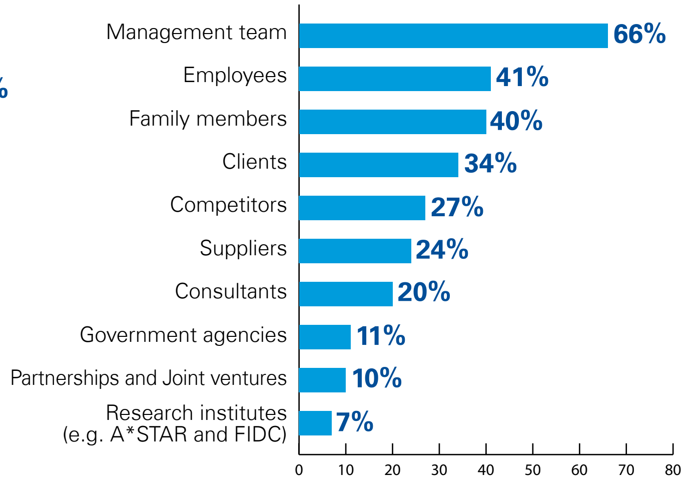
Figure 7: Respondents' views on innovation in their companies

Which of the following activities have your business accomplished so far?



Most important sources of innovation



Existing initiatives to inculcate a culture of innovation in your businesses

Note: Respondents may choose more than one option; "None of the above" is an exclusive option.
Base: All respondents (N=100)

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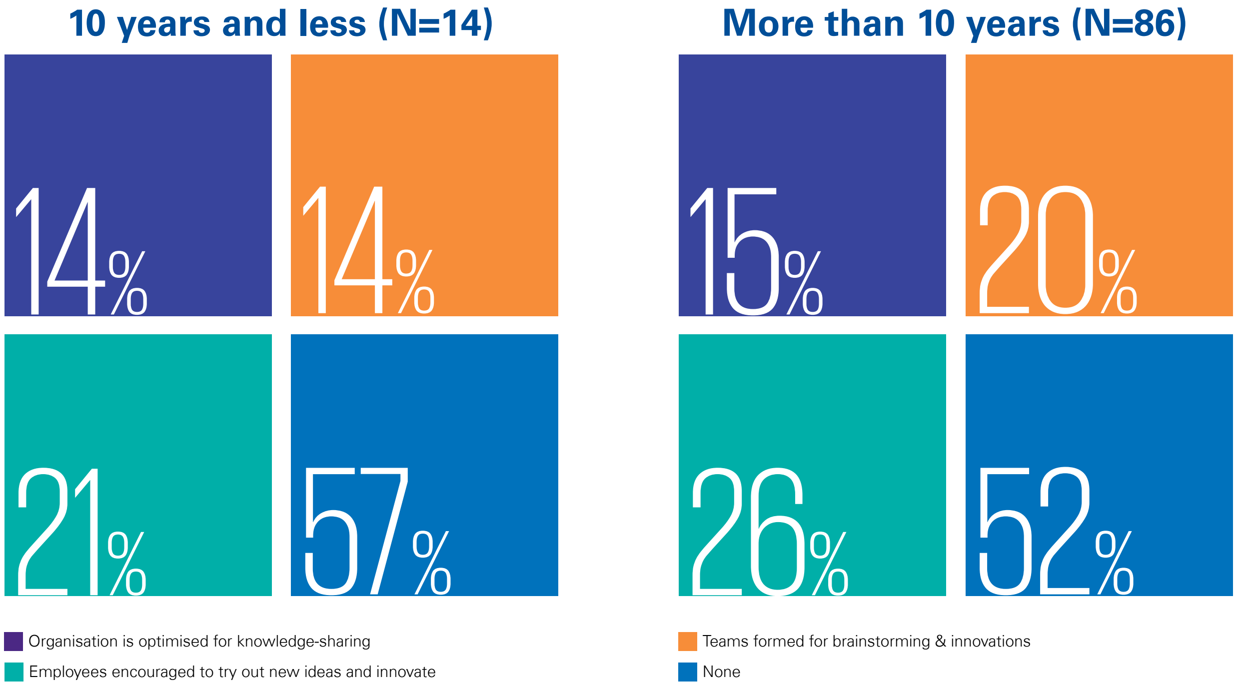
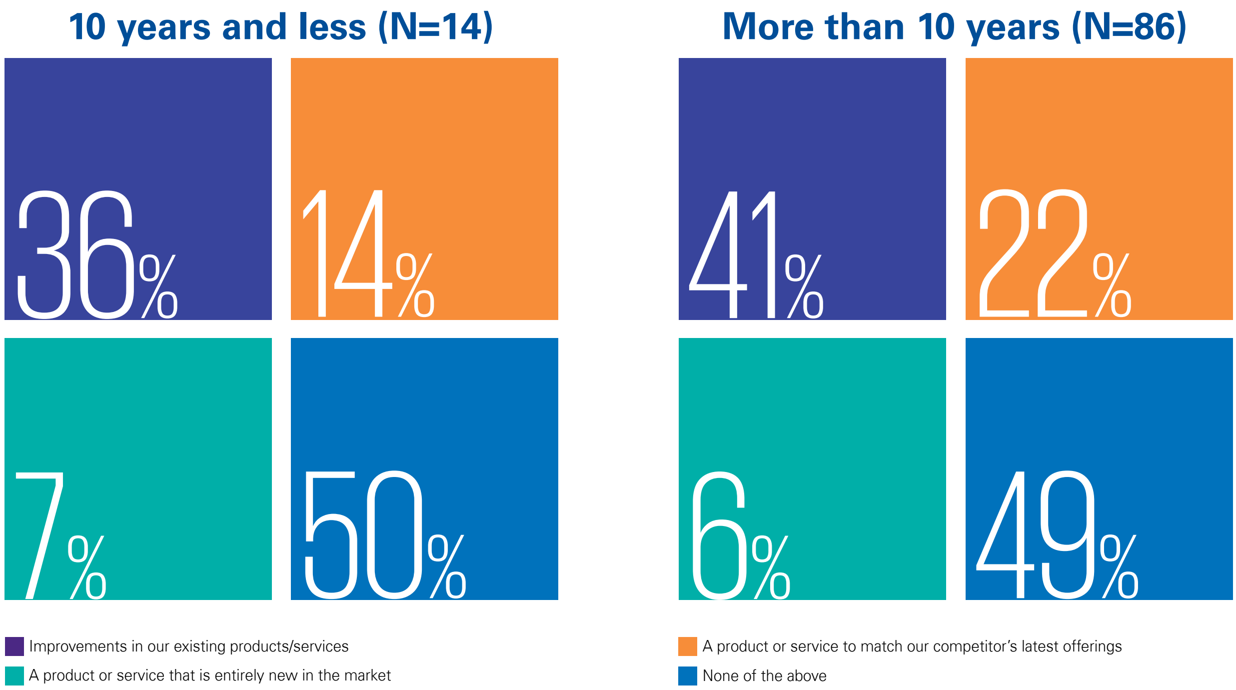
Figure 8: Respondents' views on innovation initiatives in their companies, by years of establishment



Note: Respondents may choose more than one option, "None" is an exclusive option.

Figure 9: Respondents on innovation accomplished in their companies, by years of establishment



Note: Respondents may choose more than one option; "None of the above" is an exclusive option.

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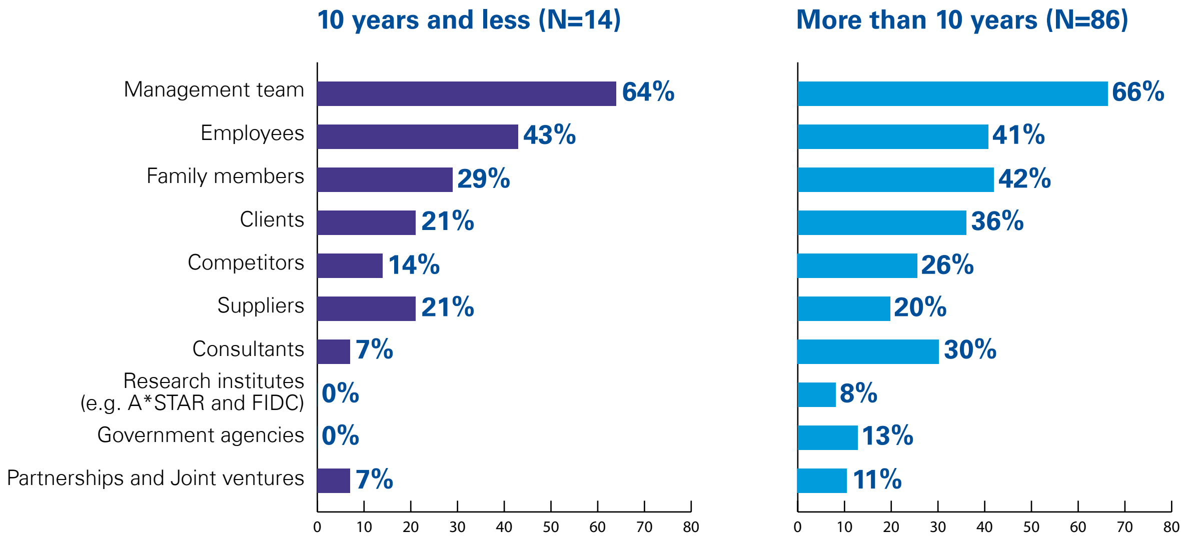
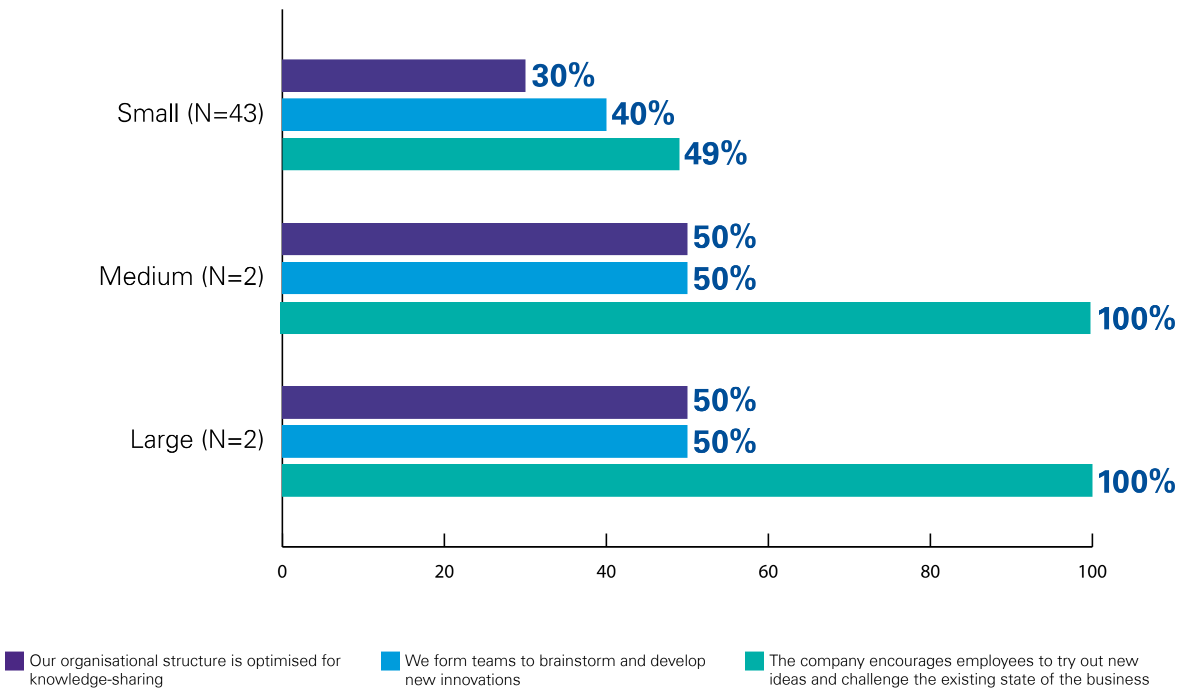
Figure 10: Respondents on sources of innovations, by years of establishment



Base: All respondents (N=100)

Figure 11: Existing initiatives implemented by innovations, by revenue



Note: Respondents may choose more than one option. Consists of companies that have indicated to have implemented some form of innovation initiatives.

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Main barriers for innovation

Most companies consider the lack of an internal culture for innovation as a very significant barrier against innovation (see Figure 12). For more mature family businesses, limited resources are a main challenge.

However, family businesses that have been established for less than 10 years, resistance to change is cited as the most significant barrier with close to 57 percent of respondents considering this as deterrent.

Innovation is about ideas, not just commercial outcomes. It should also be ingrained into a company's culture.

To cultivate a culture that fosters innovation, senior management may need to deliberately create space for innovation to happen. They may need to develop rewards and KPIs that highlight and reward the successes they want to encourage.

And while it would not be everyone's job to design a cognitive solution, every employee should be encouraged and empowered to innovate. Employees should be encouraged to think about their job, about the products and processes they touch—and how they can be improved and done more efficiently or differently.

In driving the innovation agenda, family members may also need to take a longer-term view of investments. Pursuing a mixture of long-term and short-term projects, these should include projects that are incremental and close to the company's core operations and designed to maintain competitiveness. Others should be forward-looking, aimed at engaging new customers or inventing new product offerings.

There should be step-out opportunities where the company is designing new business models for new customers and new offerings. The balance across these differing types of innovation may shift based on market conditions.

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Figure 12: Main barriers for innovation

Lack of internal culture for innovation
24%

Limited resources to support exploration of new ideas
20%

Some of our people are resistant to change
15%

Technology and development are moving too fast
7%

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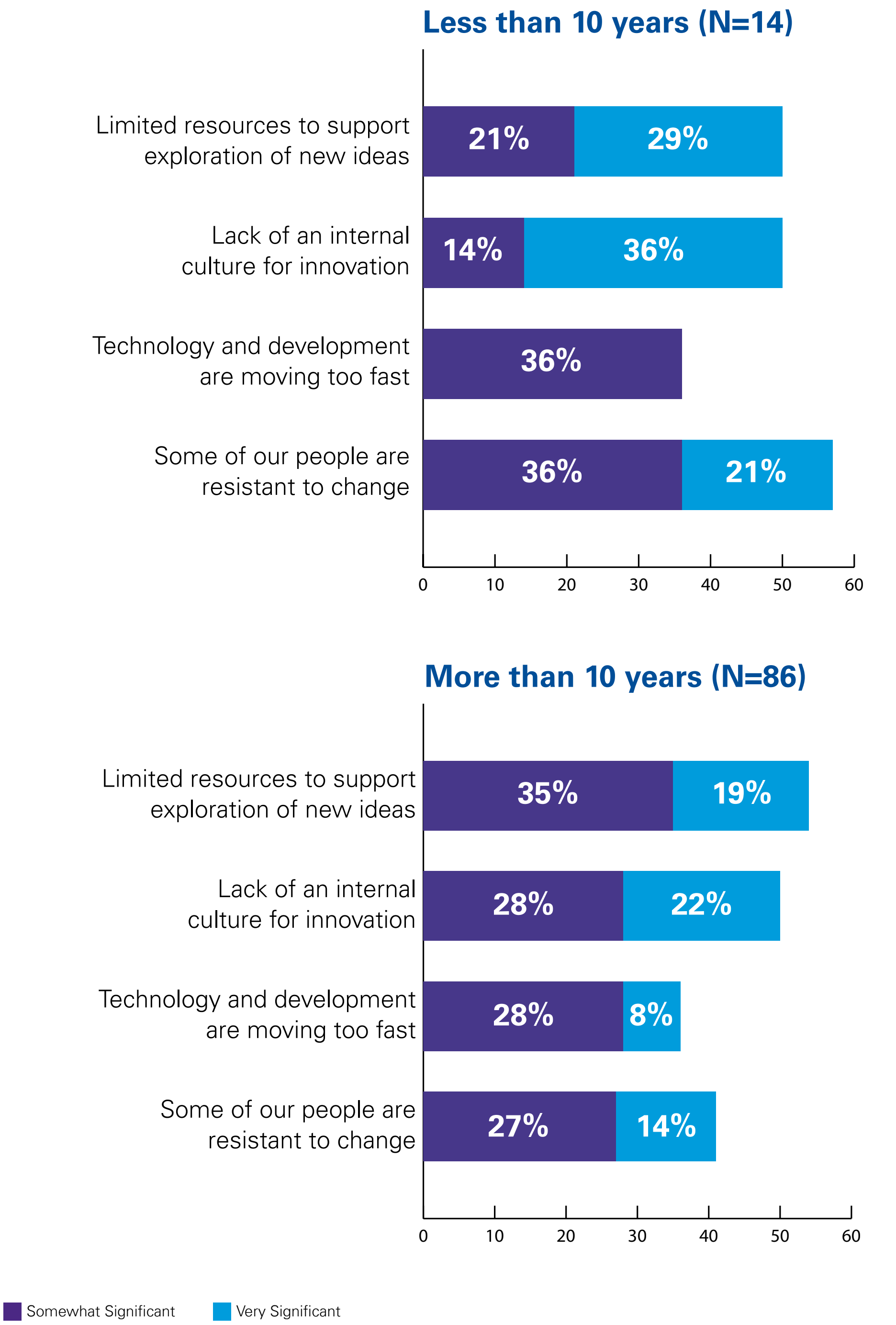
Figure 13: Key barriers against innovation, by age of establishment



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Digitalisation is a common problem faced by majority of family businesses, but issues such as manpower, innovation and succession planning plague family businesses.

Conclusion

Our study indicated that while solutions for digitalisation can be sourced off-the-shelf, and the implementation of such systems is more often "plug and play", a more fundamental issue to address is the lack of conceptual awareness of digitalisation. This to date, has not reached a sufficient level of maturity.

While 75 percent of respondents see the need to digitalise, less than 50 percent of respondents have realised its full potential. This could be the reason why most family businesses who intended to digitalise do so only to keep themselves ahead of competitors.

Beyond just converting something from analogue into digital or e-commerce solutions, digitalisation can also involve creating a digital strategy to enable innovation and agility, digital capabilities to improve the effectiveness of internal operations, or even digital solutions to cater to the changing requirements of customers.

In the area of innovation, family businesses that were able to create and introduce a new product or service are in the minority. Furthermore, newly established family businesses are not necessarily more innovative when compared to established ones.

This is likely related to the fact that family businesses operate in a "closed" ecosystem, where idea generation is centralised amongst key individuals within the organisation. In general, family businesses do not have the tendency to tap and leverage other sources of innovation, including their employees (only 41 percent have done this).

Given that family businesses are an integral part of the Singapore growth story, what more can be done to bring them into the digital economy?

Clearly, some of the early steps are already being taken. Some were outlined in the report of the Committee for the Future Economy released in February 2017, and Singapore's Budget 2017 statement.

Many family businesses in Singapore, be it small or medium in size, will be supported in their adoption of digital technologies. This includes the provision of expertise outlined in the SMEs Go Digital programme and other national initiatives such as the National Trade Platform and a National Payments Council. A dedicated programme office is also being set up to support enterprises to harness data as an asset.

There will not be a one-stop solution to bring all our family businesses into the digital economy. At the heart of it, there will be a fine balance between helping them mitigate the perceived risk and supporting those who desire to do so.

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Research Methodology

Our focus was on the qualification and selection of businesses which best represented what we determined were the characteristics of a family business.

The sample was first extracted from a published list of the top 1,000 Small and Medium Enterprises in Singapore, complemented by lists of corporate members of local trade associations. Added to this list were Singapore SGX mainboard listed and Catalist companies with up to SGD300 million in annual turnover.

The research team opined that while there are larger family businesses than in this sample, the universe of this sample would more likely provide insights relevant to the larger proportion of family businesses in Singapore.

Converging Knowledge, on behalf of KPMG then conducted the study from a random sample of 100 local family-owned businesses across eight different sectors in Singapore.

Respondents to this survey were further qualified for their affirmation as a family business. Family businesses whose ownership or management has since been taken over by non-family interests were excluded from our sample.

The survey was administered primarily through telephone interviews and email correspondence with the business founders/owners, family members who are involved in the businesses, or key senior management staff. Fieldwork for this year-long study was conducted between May and August 2016.

What makes a family business, a family business?

While our data shows that an overwhelming proportion of family businesses shareholdings are owned by family members (more than 50 percent), shareholdings composition may not be the most definitive criterion of a family business (Figure 14). Family businesses see themselves as such for a multitude of other reasons.

Participating companies were thus selected looking collectively at considerations of:

- control (45 percent)
- management (32 percent) of the company
- the likelihood that the business will be passed on to another family member (23 percent).

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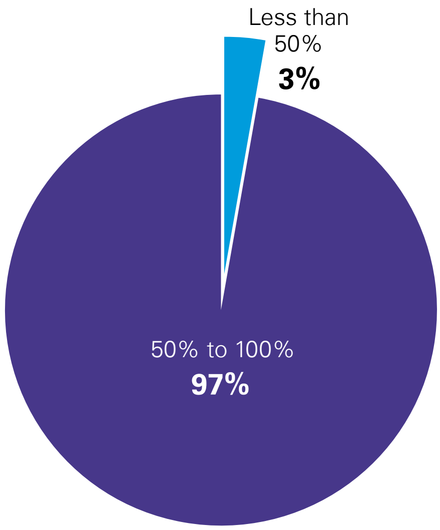
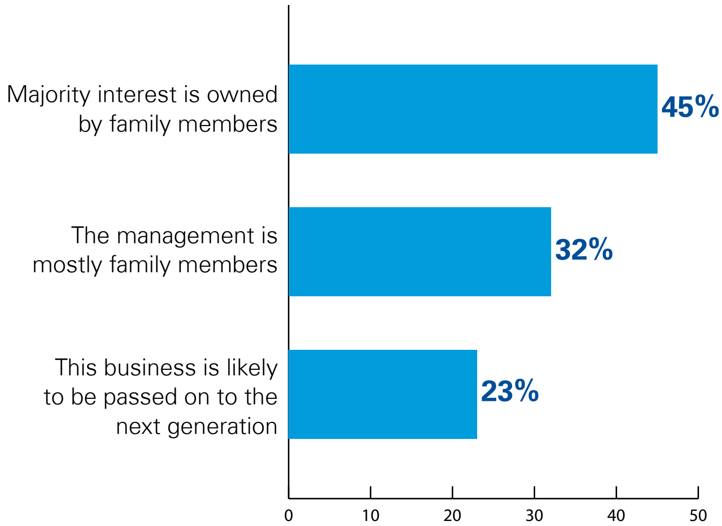
Figure 14: Key characteristics of a family business

Percentage of shareholdings by family members



Definition of a family business



It comes as little surprise that the ratio of family employees to total headcount of companies surveyed is inversely proportional to its annual revenue. This ranges from 1:21 for small businesses to 1:90 for large businesses (Figure 15). This suggests that larger companies with more revenue tend to have a smaller percentage of active family involvement, and hence, a higher level of corporatisation.

Family employees to total headcount ratio is also lower amongst businesses in sectors like Manufacturing, F&B, Engineering, and Transportation & Storage, which are manpower dependent.

Family businesses in services-oriented sectors (such as Media & Entertainment, Wholesale & Retail trade) tend to hire more family members. This could be due to a higher dependency for knowledge in the business or low barriers to entry into the business.

On average, across all spectrums, there is one family member active in the business for approximately every 26 employees, amongst the companies surveyed. This ratio diminishes in larger companies with higher revenue and varies greatly across different sectors (Figure 15).

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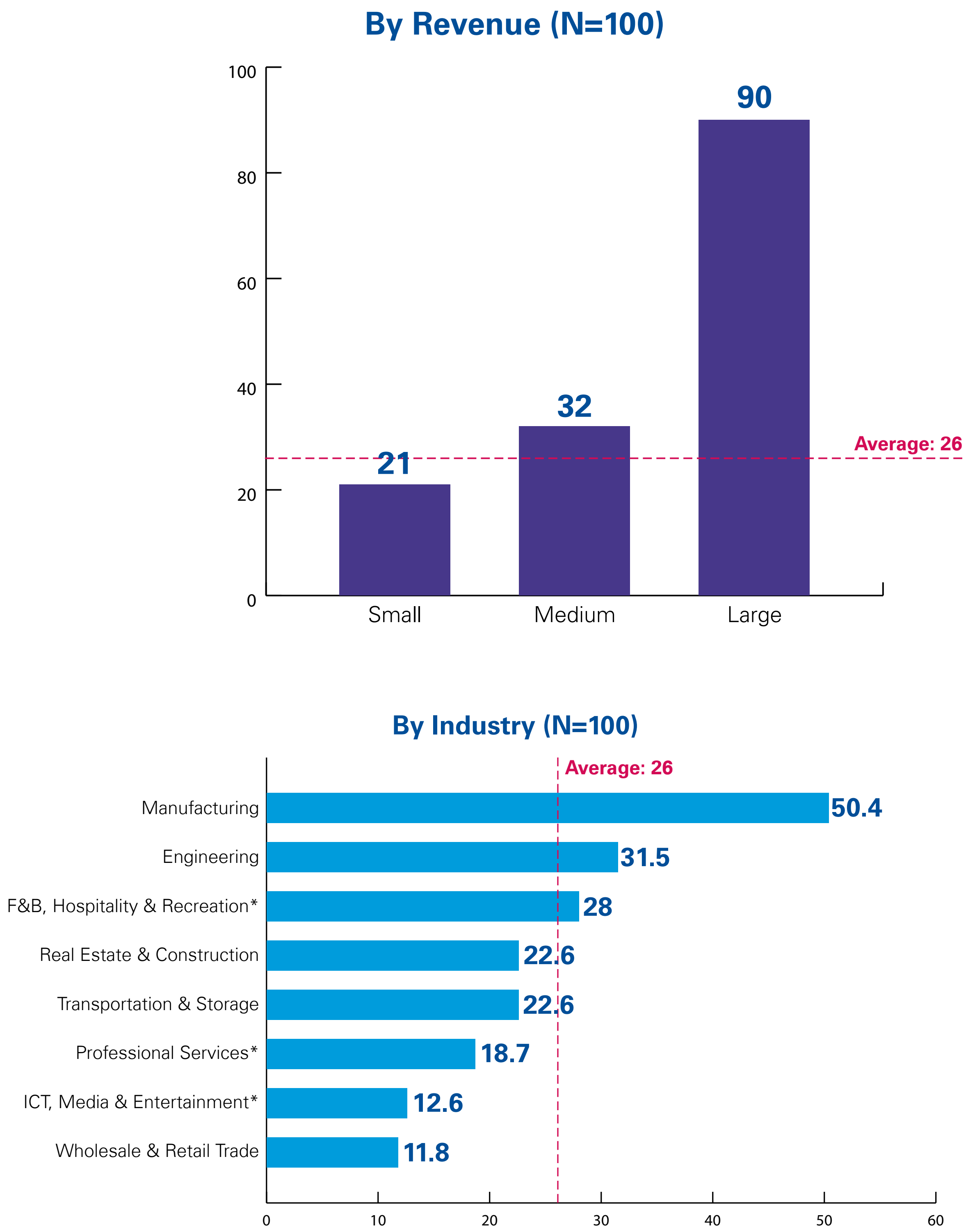
Figure 15: Ratio of total headcount to family employees



*Small sample size

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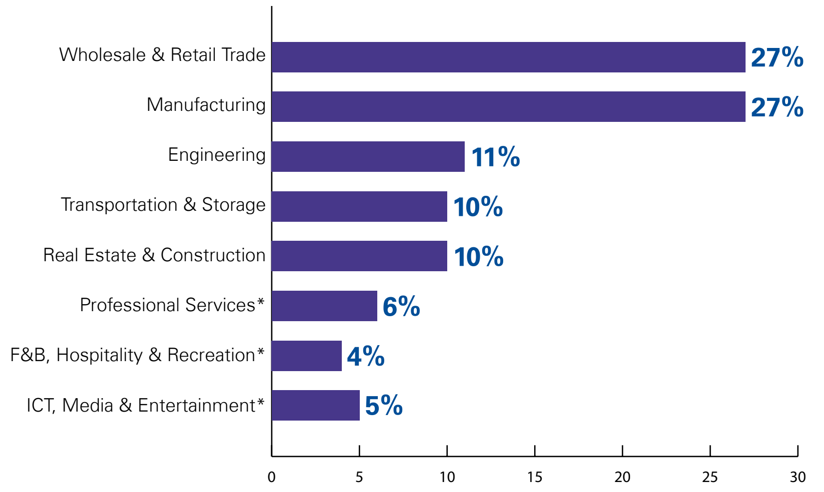
Respondent profile

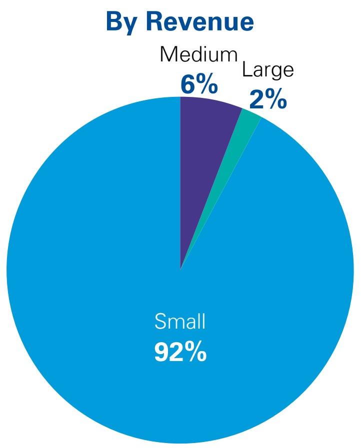
A large portion (86 percent) of the sample consists of businesses that have been in operation for more than 10 years.

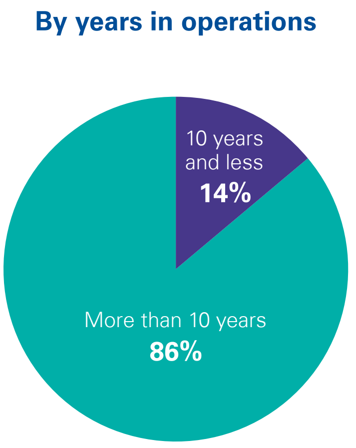
According to Singapore Department of Statistics, 99 percent of 190,100 enterprises in Singapore are small and medium enterprises, with operating receipts SGD100 million and less, or with employment of 200 or less workers[7].

In terms of revenue, majority (92 percent) of the family businesses in our sample are "Small" companies, with annual revenue of SGD50 million or less. "Medium" companies (SGD50-100 million) made up 6 percent and "Large" companies (more than SGD100 million), 2 percent.

Figure 16: Breakdown of family businesses, by sector, revenue and years in operation







*Small sample size

[7] Family employees are defined as family members that are actively involved in the businesses. For example, shareholders that are not actively involved in the business operations are excluded from this count.

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Family Businesses in the Digital Economy was written by Chiu Wu Hong, Head of Tax and Head of Enterprise at KPMG, with the support of Kelvin Lee and Elaine Tay at KPMG Digital + Innovation, and the team at Converging Knowledge.

The authors would like to thank:
Editing: Yasmin Quek & Kelvin Lee
Art Direction and Design: Foo Chui Chian

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