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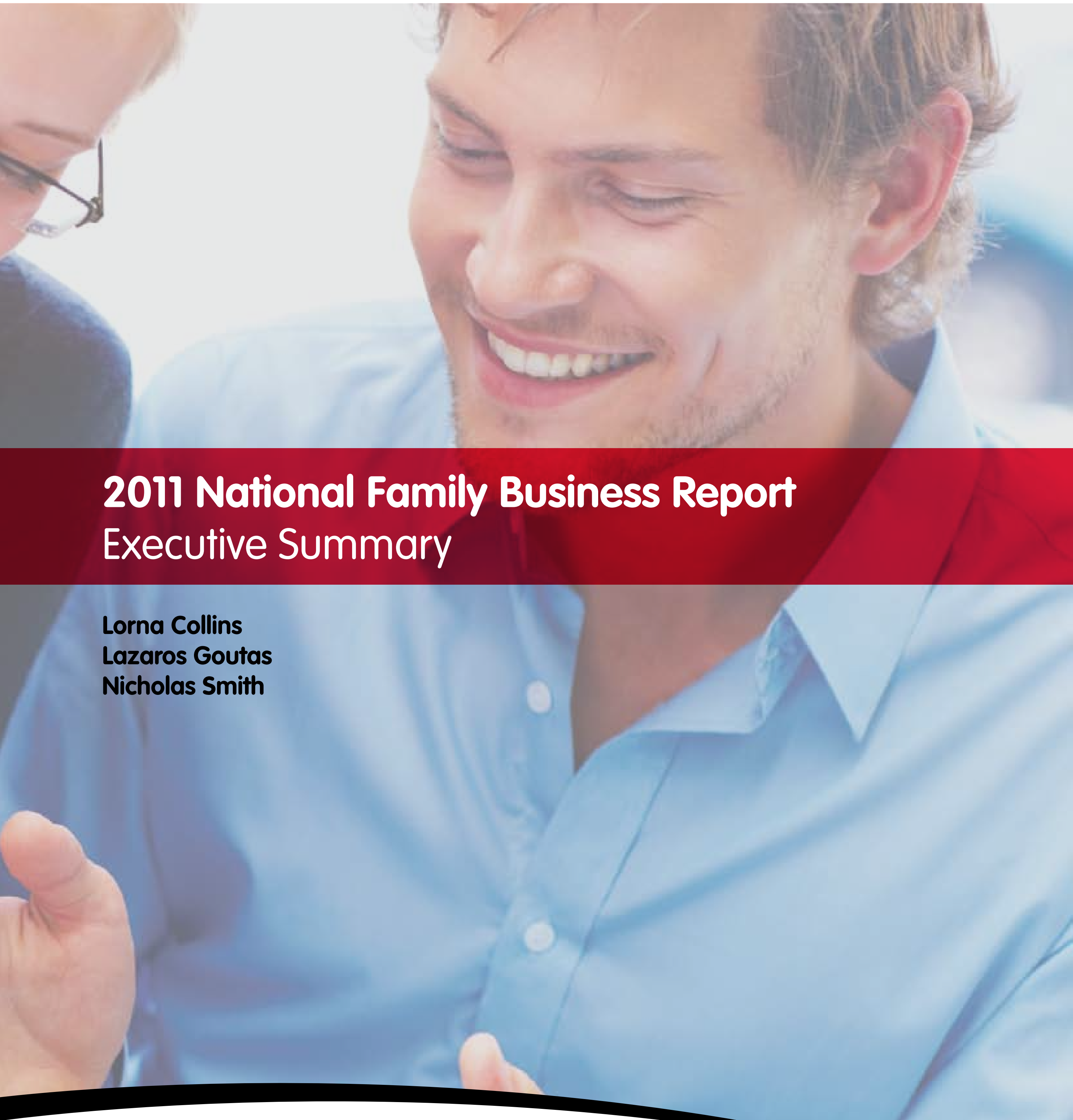

2011 National Family Business Report

Executive Summary

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bettertogether

Introduction

Welcome to the National Family Business Report 2011 Executive Summary which reports on information gathered through a survey conducted between September and December 2010. The study was jointly funded by Veale Wasbrough Vizards and the University of the West of England, and was undertaken by the Family Business Research Cluster, Bristol Business School.

The survey instrument used to collect this data was developed collaboratively by Veale Wasbrough Vizards and the University of the West of England and was administered to approximately 2,500 businesses from across the UK. The survey was distributed in online and hard-copy format. We received 233 responses; an approximate response rate of 10%. This compares favourably with typical response rates to surveys of this type. Therefore, the sample size is considered to be statistically robust and the findings drawn from this data can be relied upon and can be taken in confidence. Almost 83% of those who completed the survey were owners or founders or majority shareholders of family businesses.

The first part of the report highlights some of the key characteristics of the family businesses in our sample. The remainder of the report examines two key areas, management and governance, where family businesses are quite distinctive. Management topics considered include: decision making; aims and objectives; succession changes. Governance topics covered include governance structures and generational progressions.

This summary draws upon a detailed academic report which is available on request.

Foreword

Family owned businesses are the mainstay of the UK economy accounting for something like 66% of private enterprises and employing around 40% of the private sector workforce. Family enterprises are also the bedrock of the Veale Wasbrough Vizards' (VWV) business client base both in our Bristol and London offices.

VWV has a true dedication to understanding and supporting our family business clients. Despite the importance of family businesses to the UK economy comparatively little attention is paid to the sector by the wider business community. We were therefore delighted to be asked to work with the University of the West of England in connection with this report.

In some ways the outcome of the research may not be a surprise to those with an interest in family businesses. The findings are likely to help confirm beliefs in the positive aspects of family owned businesses including:

- that family businesses tend to have low gearing and have proved well able to survive the credit crunch with less than 17% of respondents identifying raising finance or availability of funds as a significant strategic challenge
- that family businesses are in for the long haul with not a single respondent indentifying short term maximisation of shareholder returns as a driving force of their business
- that the majority of family businesses attempt to achieve some balance of family and business interests in their decision making process and are arguably the foremost trading structure for dealing with work/life balance issues
- the relationship between longer lived and larger businesses and families that invest time and effort in working on formal governance processes

In other ways the research appears to explode some more negative and widely held myths about family business such as:

- family businesses perform poorly financially. Approximately 50% of the respondents in our survey reported increased profitability and market share during the last three years whilst the recession has been at its height
- family businesses are insular with over 30% of all respondents engaged in some form of international trade

I hope you agree that this executive summary of the report makes interesting reading. We will be pleased to hear any comments, observations and questions.

Particular thanks are due to Dr Lorna Collins and Lazaros Goutas and their colleagues in the Family Business Research Centre at the Bristol Business School for their hard work and dedication in connection with the report.

Finally we would like to pass on our thanks to all the family businesses which have participated in this research.

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1. Characteristics of the Family Business Sector

Survey Respondents:
The majority of respondents were family members who owned a particular business and were the founders, majority shareholders or owner-managers of that business (Figures 1 & 2). The remainder were non-family member professional managers.

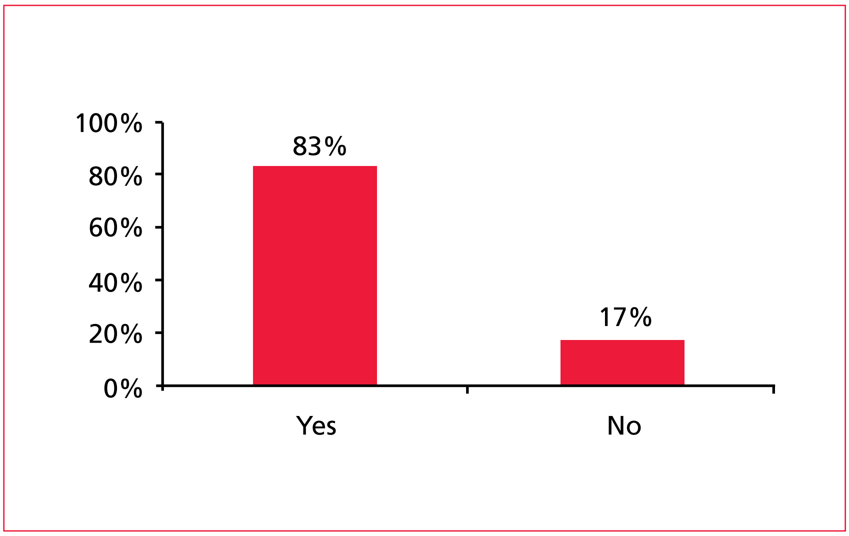

Figure 1

Are you a member of the family that owns this business?

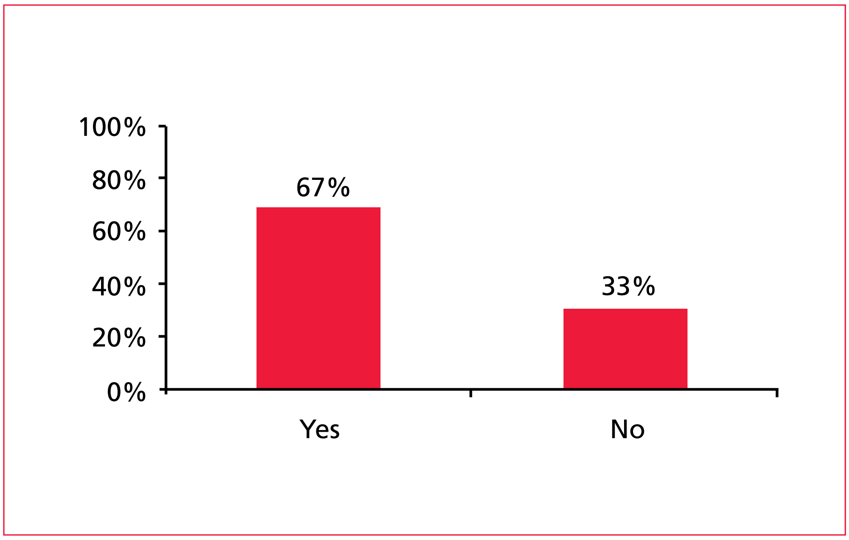

Figure 2

Are you the owner-manager, majority shareholder or founder of this business?

Management Profile:
Approximately 80% of the respondents held a senior management position in the business (Figure 3). The others who completed the survey included those who were partners of family members, or who were members of the family who did not hold management positions. These figures highlight the widespread involvement of family members in the ownership and management of their business. Management of family business is discussed in detail beginning on page 11 of this Executive Summary.

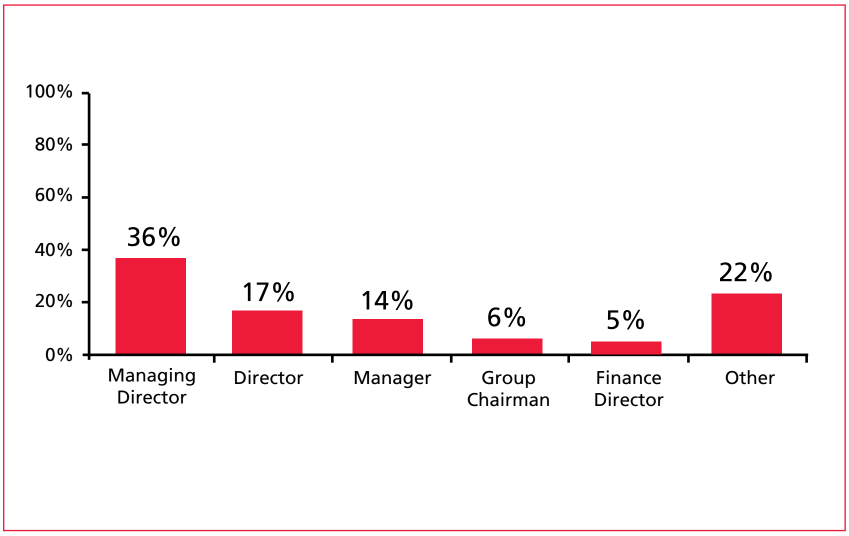

Figure 3

What is your title and role within the business?

Structural Characteristics:
In terms of their size, family businesses follow a similar distribution to the wider population of firms in the UK (Figure 4). 75% of the family businesses in our sample are classified either as micro-firms or small firms (see Table 1 for the European Commission Classification Scheme). An additional 19% of family businesses are classified as medium-sized and a remaining 6% of the family businesses are large firms.

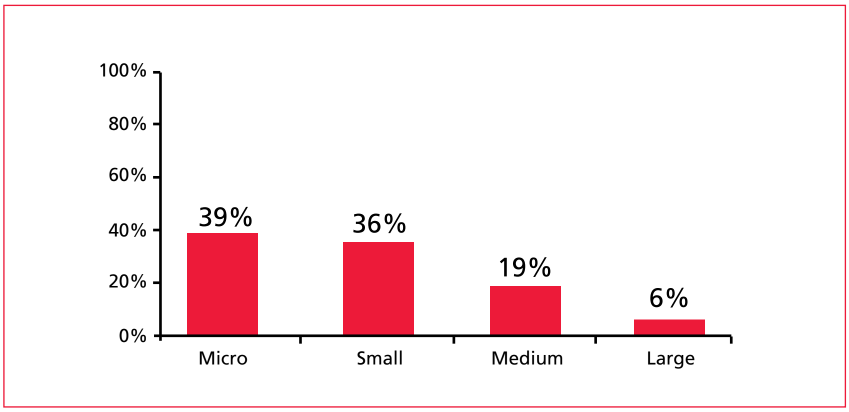

Figure 4

What is the size of your business?

Enterprise category	Number of employees	Turnover	Balance sheet total
Medium-sized	< 250	≤ € 50 million	≤ € 43 million
Small	< 50	≤ € 10 million	≤ € 10 million
Micro	< 10	≤ € 2 million	≤ € 2 million

Table 1

European Commission Classification Scheme, according to number of employees, turnover and balance sheet total

Generation of Ownership:
The majority of firms in our sample are in the first generation of ownership. Second generation firms accounted for 21% of our sample; 9% were in third generation; 5% were in fourth generation; and 3% were older. This profile is consistent with other published profiles of the family owned business population in the UK.

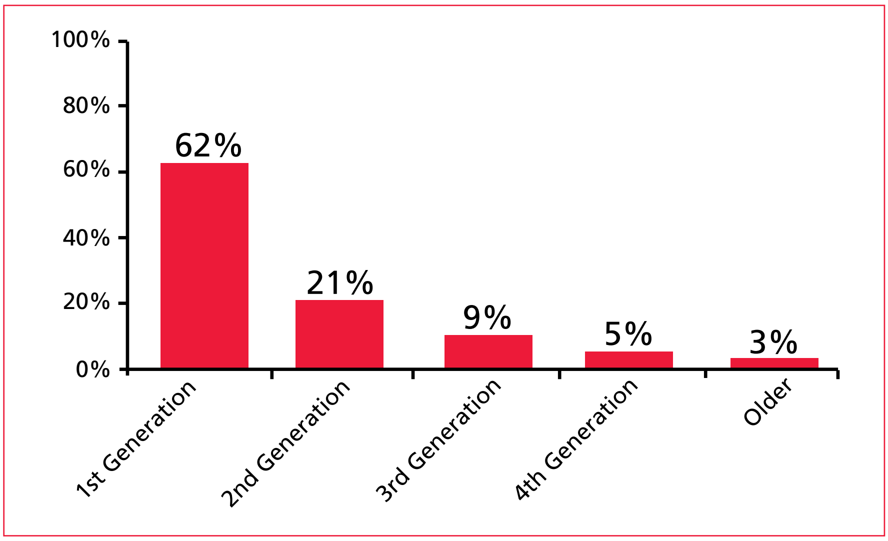

Figure 5

Generation of family members involved in the business?

Ownership Progression:
Our study also identified a significant positive relationship between the generation of family members owning the business and the size of a given firm. The majority of first generation family firms are micro or small size. The majority of fourth generation and older firms are large in size and there is a complete absence of micro firms in the third or later generation of ownership.

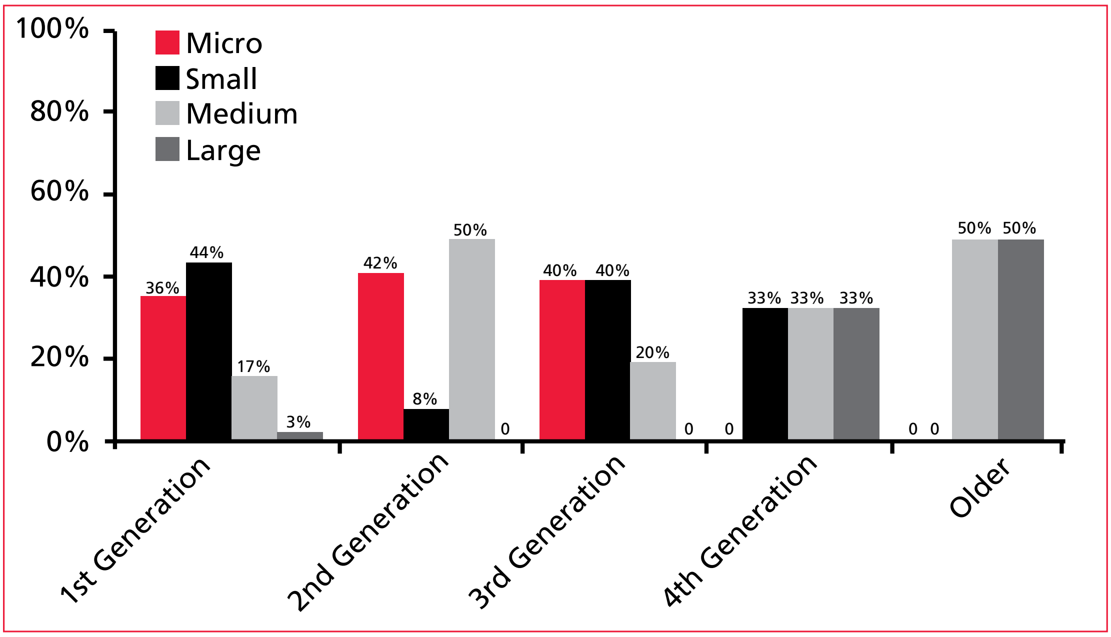

Figure 6

Firm size mapped against generation

Sector Activity:
Our survey asked respondents for their perceptions about the level of sector activity. Although family businesses are often characterized as operating in relatively settled industrial sectors, our respondents reported that the average rate of mergers & acquisitions (M&A) and organizational restructuring for the past 2-3 years was somewhat high (Figure 7). This is not unexpected given the increased rate of change, uncertainty and consolidation that has been taking place in most industrial sectors in the UK.

The perception of our family businesses owners is that their industry is relatively unstable however when asked if they anticipate any ownership changes (page 13) the majority (52%) reported that they anticipated ownership changes more than 2 years in the future. This is paradoxical because M&A activity is reported as being somewhat high and we would therefore anticipate that some firms in the sample would be targets, yet owners do not foresee any changes in ownership in the forthcoming years. We might infer from this that the firms in our sample do not consider themselves as potential targets.

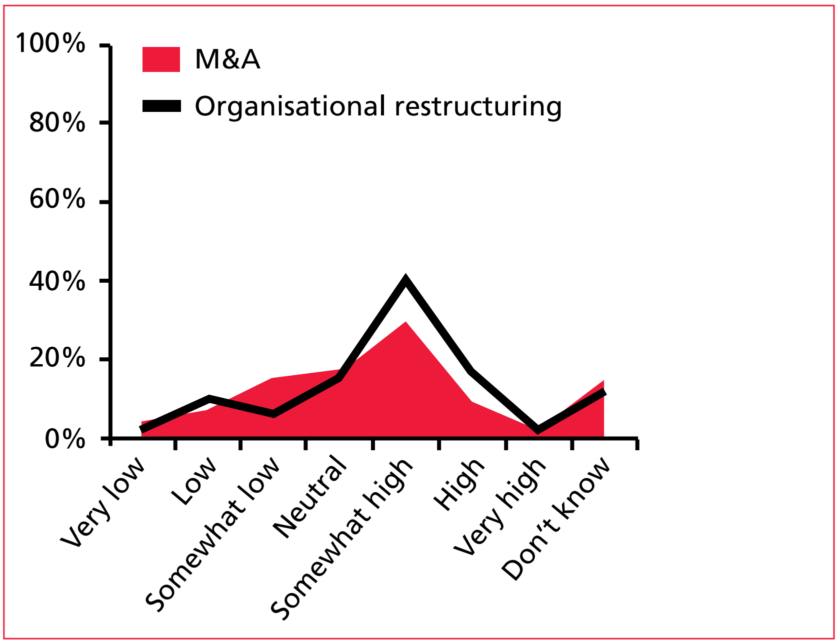

Figure 7

Rate of M&A and organisational restructuring

Markets:
In our sample over 67% of the family businesses trade only in the UK. This is not surprising given that the majority of small and medium-size firms tend to cater only for local markets. Nevertheless a high proportion of family businesses (23%) do engage in some level of international activity.

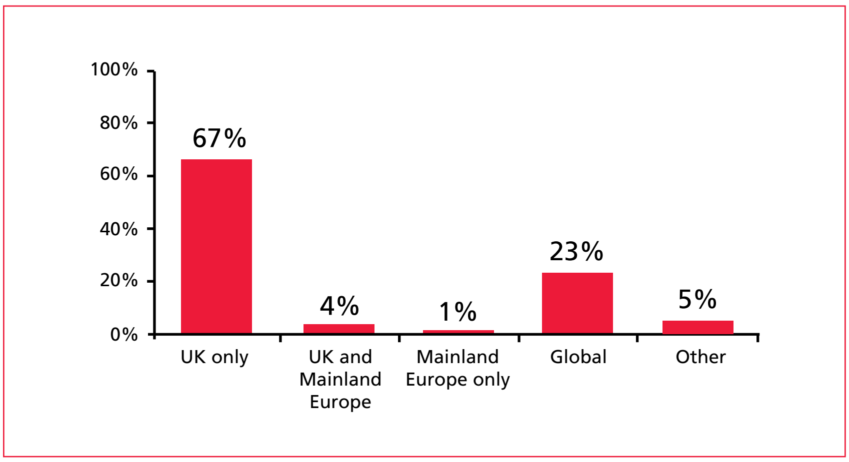

Figure 8

Where does your business trade?

Profitability and Market Share:

We asked family businesses to tell us about what has happened to their profitability and market share in the past three years. The majority reported an increase in their profitability and market share during this time (Figure 9). These figures challenge the conventional belief which views family businesses as 'laggards' when compared to other businesses during times of challenging economic conditions. However, we must be slightly cautious as these claims have not been verified by external or third party review.

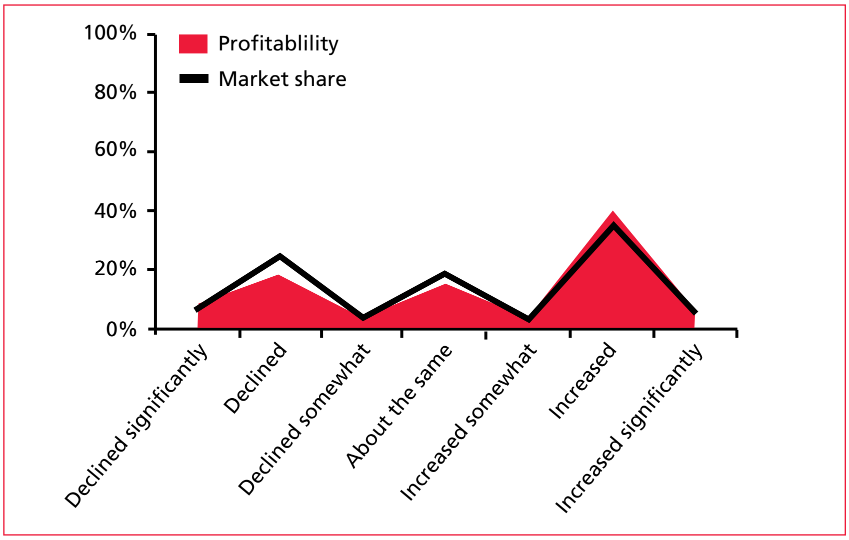

Figure 9

What has happened to your profitability and market share over the past three years?

Strategic Aims:

Respondents were asked to indicate if their strategic focus was on stabilizing profits or growth (defined as increasing revenue in this survey) (Figure 10). While some preferred not to answer this question the majority responded that their main aim was to increase revenue, profitability and long-term value indicating that the majority of firms in the sample have a growth focus. This indicates that family businesses in this sample are growth oriented and therefore not content to maintain the 'status quo.'

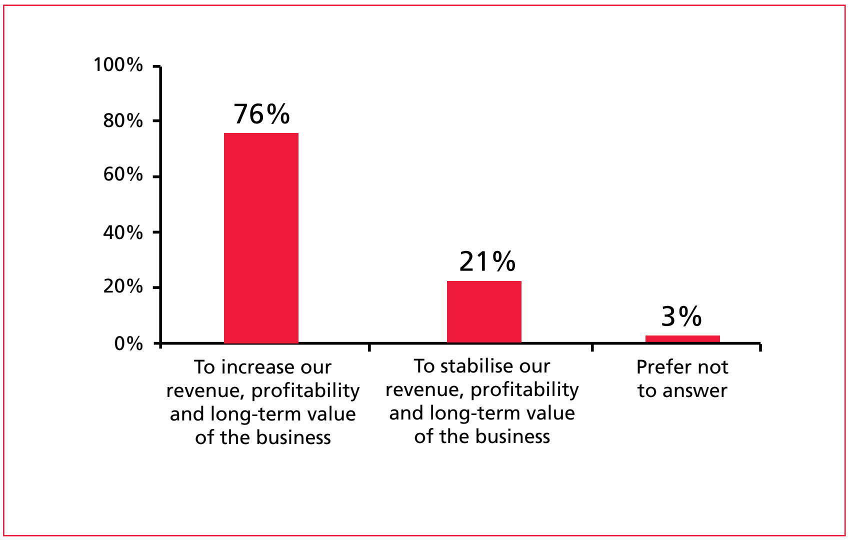

Figure 10

What is the main aim of your business?

Investment:
The majority of family businesses continue to rely on the traditional financing channels in order to fund their business activities. Debt and internally generated income remain the primary means of financing for family businesses, whereas alternative forms of finance (e.g. venture capital investment or business angel financing) do not appear to play a central role in the financing structures of family businesses (Figure 11). The shorter-term focus of these alternative forms of finance largely explains the low rate of adoption of these financing forms, given the long-term investment horizons that typically define family businesses.

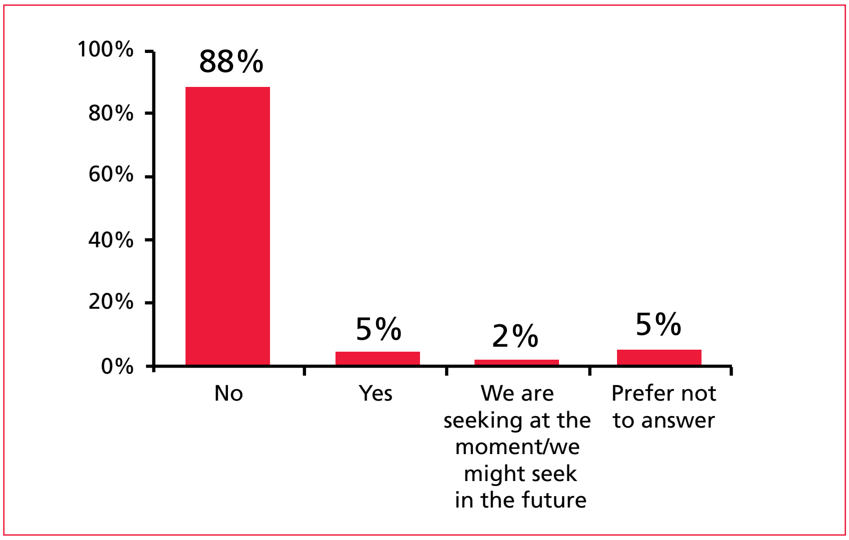

Figure 11

Has your business ever obtained/is your business currently seeking any private equity investment?

Conclusion

The main results concerning the family businesses in our sample can be summarised under the following points:

- in terms of size, family businesses follow a similar distribution as the wider population of UK firms
- family businesses do not appear to be excluded from any particular sector, even though the majority of these firms tend to focus on serving local markets
- the long-term commitment of family members towards their business is largely associated with the reliance of family business on the more traditional sources of finance.

In summary, this long-term perspective constitutes one of the defining features of family businesses. At this stage it is interesting to examine another key area where we find that family businesses exhibit a number of distinct properties, namely the management of the family business.

2. Management of the Family Business

Decision Making:
Family relationships are irrevocably intertwined with the management of family businesses. The influence of these relationships in business matters is reflected in the ways in which decisions are made (Figure 12). Therefore, even though a large number of respondents confirmed that business comes first when making a decision, the majority of respondents highlighted the inherent 'tension' between family and business-related objectives that is encountered in family businesses.

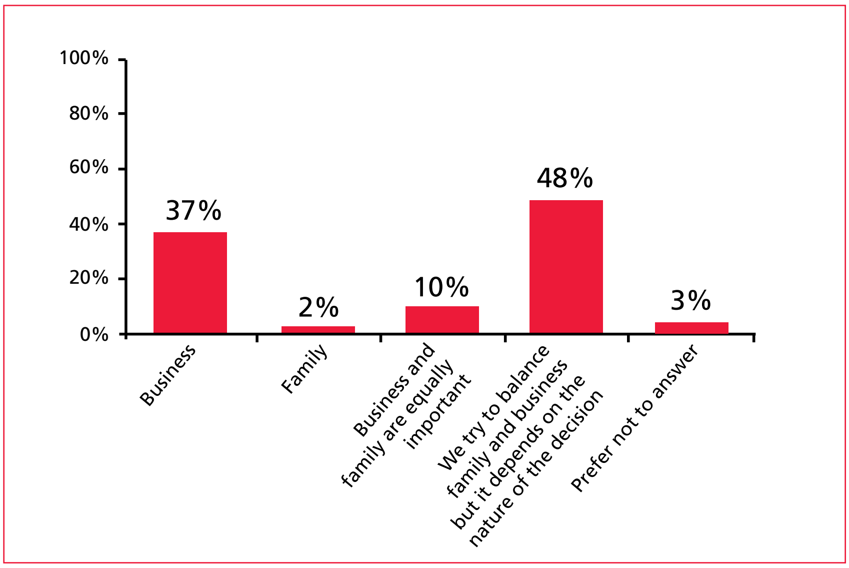

Figure 12

When there is a decision to be made that relates to the business, which comes first?

Discussing Issues:
Respondents also identified a diverse mixture of settings where business issues are discussed (Figure 13). These results are not related to the size of a family business or to the generation of family members that own and manage a business. A number of the larger second and third generation family businesses exhibit such informal approach, which should not be seen as an obstacle towards growth, but rather as a unique feature of family businesses that allows these firms to overcome the formal constraints that are normally associated with running a business.

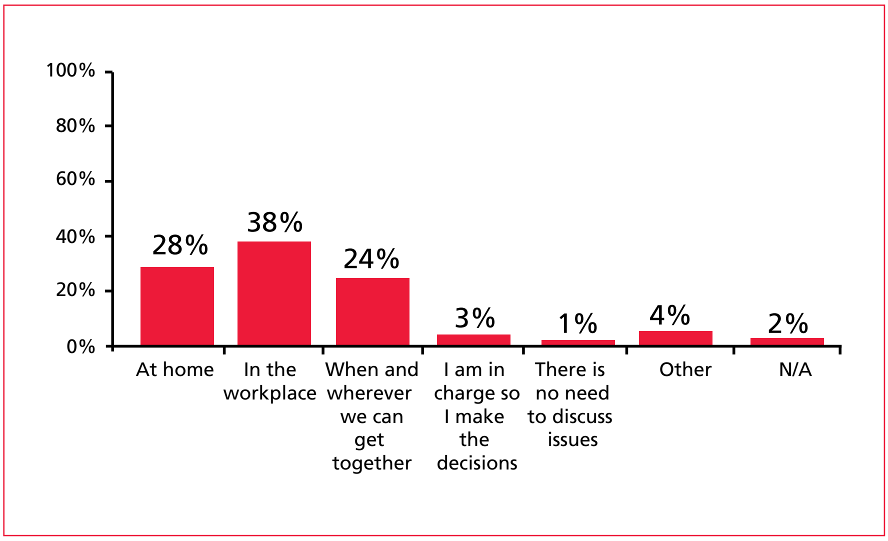

Figure 13

Where do you and other family members discuss issues concerning the business?

Primary Aims:
The effects of family dynamics on the management of family businesses are manifested in the aims and objectives of the family members responsible for managing the business, as well as in the long-term strategies that a family business develops in order to attain these objectives. The vast majority of the respondents in our survey, approximately 58%, reported that providing a regular source of income was the primary aim of their business.

An additional 15% reported that their business is managed with the primary objective of building a legacy for future generations (Figure 14). None of the businesses in this survey identified the short-term maximisation of shareholder returns as a primary aim of their business, which not only differentiates them from other forms of business organisation, but also highlights the long-term focus of family businesses and the increased dependence of family members on their business.

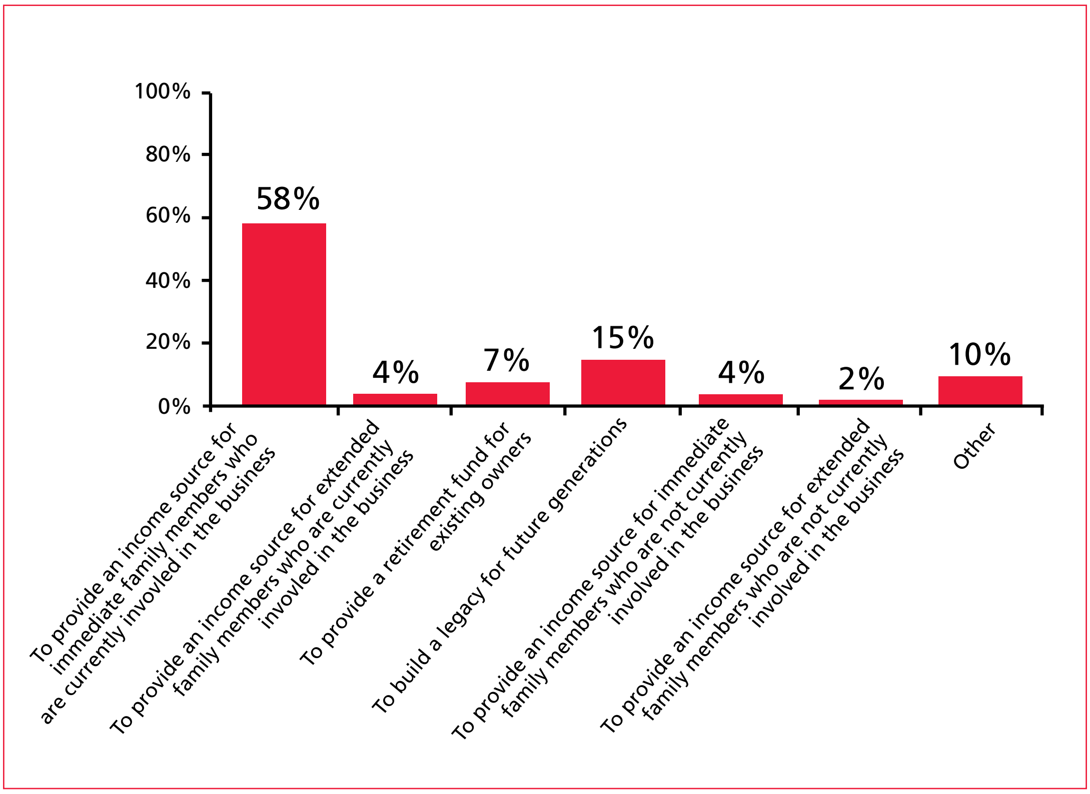

Figure 14

What is the primary aim of the family business?

Succession Changes:
Long-term commitment and personal involvement of family business owners is also reflected in the ownership/ succession plans of the surveyed firms.

The majority of family businesses plan to have a succession in the long term (more than two years from now) (Figure 15). This shows that ownership and management transition rates are relatively stable. If these businesses had objectives which involved growth through major change such as acquisition, merger or exit (sale or dissolution of business) then it would have been likely that respondents would have chosen to report a higher rate of uncertainty with regard to their future plans.

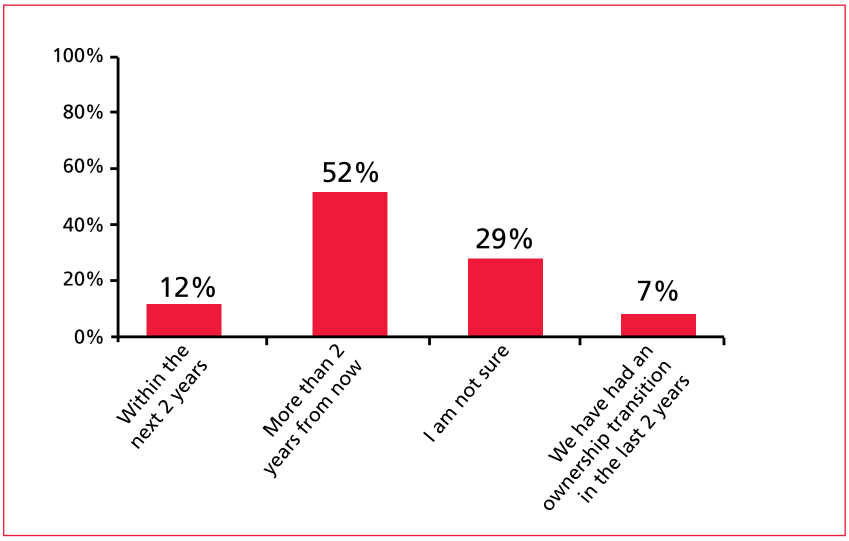

Figure 15

When do you next anticipate ownership/succession changes?

3. Governance of the Family Business

Governance Structures:

Corporate governance refers to the set of relationships between management, owners, shareholders and other stakeholders[1]. It is "a system of structures and processes to direct and control corporations and to account for them"[2]. Systems of corporate governance regulate relationships between shareholders and provide control where the shareholders of the business are different from those responsible for its management. The overlap between the ownership and management of a business has in many cases led to the incorrect assumption that the concept of corporate governance need not necessarily apply to small family businesses. However, many second or third generation family businesses have shareholders who are not actively involved in the management of the business and so need to have systems of governance to regulate relationships between active and inactive shareholders. Research has also shown that firms that implement formal governance structures before taking the step to separate ownership from day-to-day management face fewer problems when they final make this progression.

Previous academic research has shown that problems between shareholders can also arise in family businesses where all of the shareholders are actively involved in managing their business. Such problems can include: eliminating minority shareholders from directorships and excluding them from company employment; high compensation to majority shareholders; siphoning off earnings by having other enterprises (owned by majority shareholders) perform services for it at high prices. In summary, systems of corporate governance seek to mitigate such problems by providing coordination of relationships between key business shareholders.

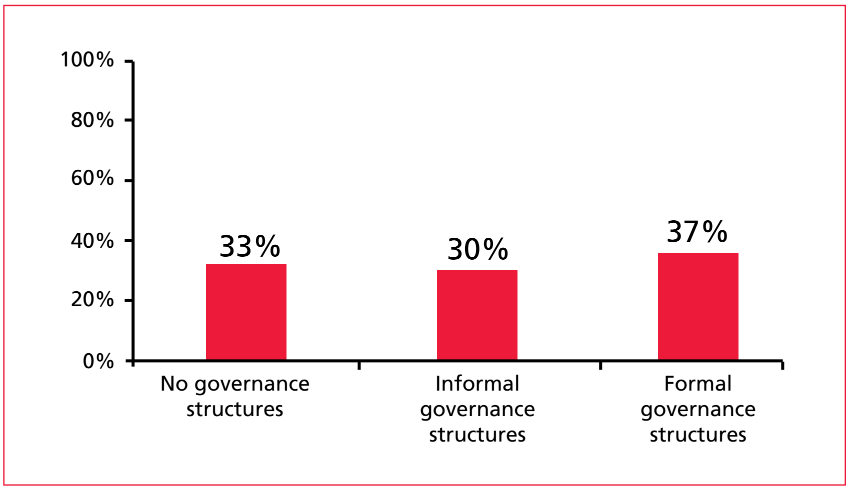

Figure 16

Governance structures adopted by family businesses

The board of directors is widely acknowledged to be the main intra-firm institution through which the monitoring and controlling of top management teams takes place within corporate organisations. However, many firms and especially small and medium-sized firms are characterised by inactive boards (boards that don't monitor the actions of senior management and hold them accountable for their actions). According to the academic literature on family businesses, family councils or assemblies can act as substitutes or complements to the board of directors. In addition, the literature on the governance of family-owned and closely held (few family members own shares) firms has also identified a number of alternative mechanisms through which corporate control can be exercised. These mechanisms can refer to certain formal controls, such as shareholder agreements and the articles of association, as well as to a number of informal controls, such as a high degree of trust, a shared vision and commitment to the firm by its owners and top management team. Existing research has also shown that this high degree of owner commitment leads to more responsible behaviour in the management of a business.

Of all the firms in our sample 37% reported having formal governance structures, while over 63% have informal or no governance structures in place (Figure 16).

[1] Monks and Minow (2008)

[2] Neubauer and Lank (1998: 60)

Adopting Structures:

It is interesting to examine how the information outlined above relates to the governance structures of the family businesses in our sample (Figure 16). In our sample approximately 37% of the firms reported having formalized governance structures (e.g. active board of directors controls the actions of top management team members, partnership agreements, minority shareholder protections or articles of association that formally delineate shareholder relationships). Most importantly, however, more than 60% reported that governance structures are either informal or nonexistent. We did not provide a definition to respondents of what constitutes governance structures and we therefore suspect that there may be some incorrect reporting of actual structures in place. We could also hypothesize that a significant proportion of family businesses are unaware of the role, impact and effects of governance structures or remain hesitant to implement governance structures.

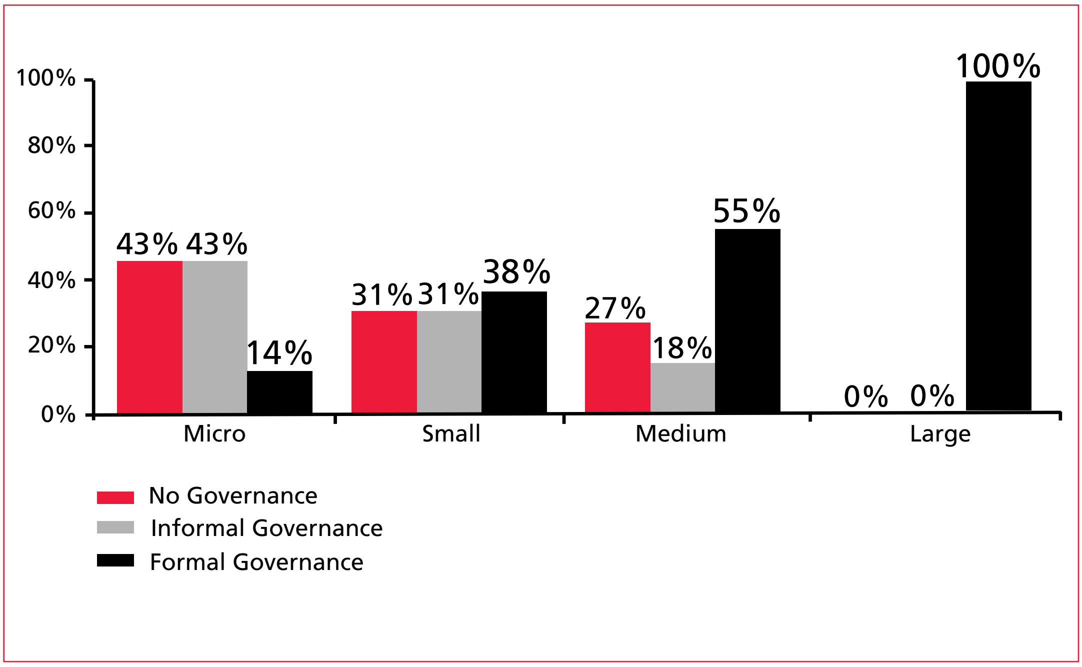

Figure 17

Degree of formalisation by firm size

The degree of formalisation of the governance structures adopted by a family business is associated with the firm's size. Our study identified a significant positive relationship between firm size and the adoption of formal governance structures (Figure 17). We found that 100% of large firms in our sample reported having formal governance structures and were limited companies. This leads us to conclude that as family businesses become larger they are more likely to adopt formal governance structures and limited company form.

Structures in Older Firms:
The longevity of family businesses is also associated with the implementation of governance changes and transitions. The older a family business is the more likely that it will have implemented governance changes. Most governance changes are made in firms that are in their second generation of ownership (Figure 18) making the second generation firms in our sample the best governed. Once these changes are implemented, third generation and older firms share similar governance profiles.

Getting older doesn't guarantee that a firm will have governance in place and this is shown by the fact that 29% of older firms have no governance in place. However, going back to results outlined on the previous page getting larger does! Our results show that large older generation family businesses are the ones most likely to have formal governance structures. We might hypothesize about why this is the case. It may be that some firms in highly regulated industries like education and health care are concerned with compliance and the need to comply necessitates more formal governance structures. Similarly we might conclude that firms operating in a dynamic and changing environment are more likely to view governance structures as one way of dealing with increased complexity. However, at this point are not able to confirm or refute these hypotheses.

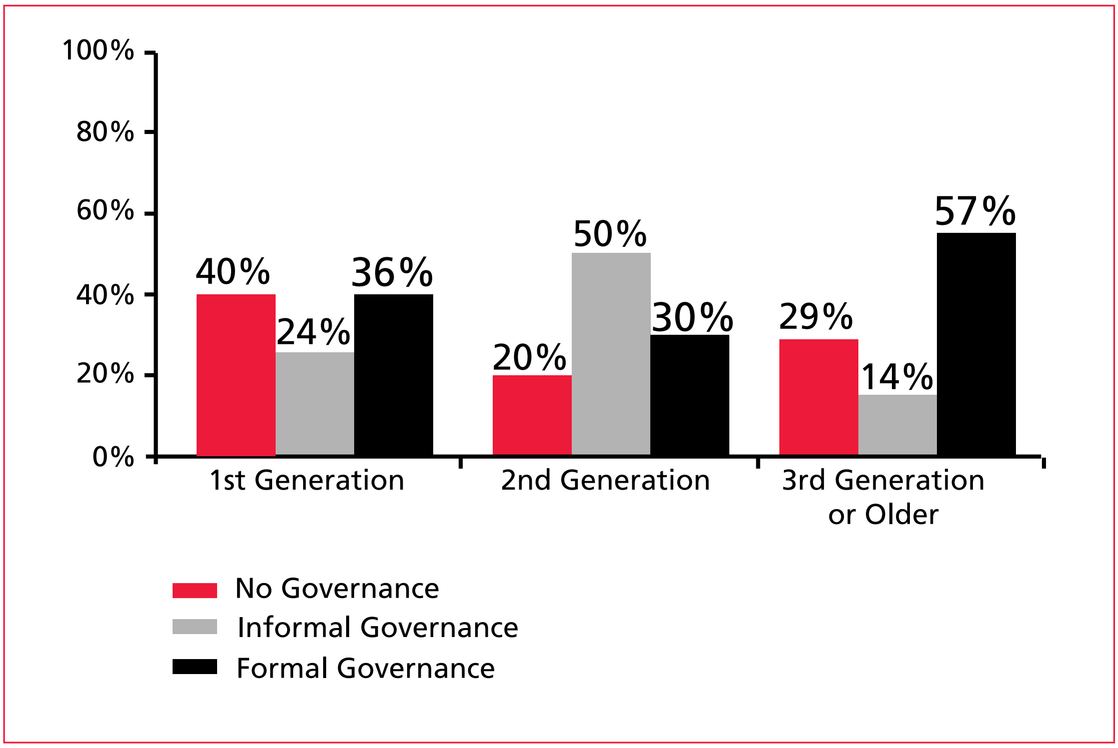

Figure 18

Adoption of formal governance structures according to the generation involved in the business

Summary

The results of this survey confirm our initial views that family businesses share a number of distinctive features that differentiate them from other types of business organisation. Such differences are manifested in a number of areas. Family businesses try to balance both family and business needs in decisions that they make. The primary aim of these businesses is to provide an income source for immediate family members. Their ownership is relatively stable even though they operate in somewhat turbulent industry sectors. Our analysis showed that a significant majority of all the firms in our sample had governance structures in place and that second generation firms are the best governed. We also found that all the large long-lived family businesses in our sample had formal governance structures but that age did not guarantee that formal governance practices were in place.

There is a myth that family businesses tend to be introverted and resistant to growth. Our findings show this not to be the case. We identified a clear relationship between the size of family businesses and their age. The vast majority of medium-size family businesses in our sample were in their second generation of ownership. The bulk of large firms were in their third generation or older of ownership.

Finally we found an interesting anomaly in governance structures between different generations of ownership. Family firms at first generation reported high levels of informal and formal governance structures already in place. This perhaps shows that families are starting businesses with good governance in mind. Second generation firms are where the biggest change occurs in governance in so far as the jump from having no governance to having some kind of governance is substantial – changes from 60% to 80% – showing perhaps that awareness of governance as a key to success and growth is becoming more accepted by family business owners. Third generation or older firms typically have a governance profile which is predominantly focused on formal structures but a significant proportion still have no governance in place. This shows perhaps that their progression through the second stage was accomplished relatively smoothly and the need for structures to guide this less profound. We cannot claim at this point to understand the reasons fully but nonetheless it is an interesting finding which merits further investigation.

Even though the academic literature has widely acknowledged some of the positive effects of family dynamics on growth and organisational performance, the particular reasons why family firms adopt and exhibit certain characteristics and structures remains under-researched. We have some initial data that points toward some possible relationships between different attributes, structures and growth and will seek to comment on this in more detail in our subsequent report.

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Veale Wasbrough Vizards acts nationally for clients in the Family Owned Business, Education and Charities, Healthcare, Private Wealth and Public Sectors. The firm also offers a dedicated service to individuals.

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The Family Business Research Cluster, which is part of Bristol Business School, conducts leading research in the field of family business.

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