Values and purpose create competitive advantage for family businesses

Global Family Business Survey 2018 – China Report
Executive Summary
Mr. Li Ka-shing, one of the most famous entrepreneurs in Hong Kong announced his retirement in March this year and handed over the reins of his conglomerate to his son Victor Li. While Victor has been groomed over the past many decades, analysts are watching to see how he will oversee the empire his father has built. Mr. Li plans to spend more time on his charitable foundation to which he has devoted one-third of his assets. Referring to the foundation as his “third son”, he aims to reinforce the business’s values of being committed to the communities it operates in.

Succession planning is indeed critical for family businesses hoping to create a lasting legacy. This is particularly true for Asian businesses founded after the Second World War that are now transferring their wealth to the next generation. Family run firms are also being pressured to uphold their sense of purpose and values from an ever more discerning consumer base. The mainland China and Hong Kong findings of the Global Family Business Survey 2018 sheds light on these themes and how they impact family businesses in these economies.

The key findings from this report are as follows:

**Family businesses have seen higher sales growth over the past 12 months compared to the global average and are active strategic planners**

- More family businesses on the mainland have seen higher sales growth over the past 12 months (75%) compared to the global average (69%). Out of this, 67% of mainland respondents saw double digit year-on-year growth in 2018, roughly double the global proportion of 34%. Additionally, close to all mainland family business executives have a strategic plan for the next three to five years (96% compared to 79% globally).

**Family businesses are more bullish than global counterparts in terms of growth aspirations over a two year time horizon**

- In China, 26% of family businesses expressed “quick and aggressive” growth aspirations over a two year time horizon compared to 16% of their global counterparts. In terms of “steady growth” aspirations over a two year time frame, 51% of Chinese family businesses shared this view compared to a global average of 68%.

**Family businesses have embraced digitalisation to a greater degree than their global peers**

- More mainland family business owners are investing in digital capabilities than their global counterparts (63% compared to 57%). Compared to their global peers, fewer decision makers on the mainland and in Hong Kong also report feeling vulnerable to digital disruption (mainland: 12%, Hong Kong: 27%, global average: 30%).

**Family businesses find that the need to innovate in order to keep ahead is the key challenge that they face**

- 77% of mainland family businesses state that the need to innovate is a key challenge that they face. Over half see the economic environment (58%) and the lack of professionalisation of the business (52%) as issues.

**Family businesses have a clear sense of values but lag behind global counterparts in terms of governance structure**

- 71% of mainland family businesses have a clear sense of agreed values and purpose as a company compared to the global average of 79%. 94% of mainland respondents believe that a clear sense of values and purpose have helped to create a competitive advantage (versus 75% globally).
• However they lag behind their global counterparts in terms of conflict management and gender representation, both of which contribute to economic performance and longevity. 13% of mainland family business decision makers admit that they ignore conflict because of societal norms which is slightly higher than the global average of 9%.

• Only 15% of board members are women in mainland family businesses (global average: 21%) and 15% of next generation family members working in the business are women (global average: 23%). There is room for improvement to increase women's representation in both these areas in order to ensure the business is incorporating diverse perspectives and therefore run sustainably.

Family business owners are less inclined to plan for succession in spite of wanting to preserve continuity

• 21% of mainland family businesses currently have a succession plan in place, compared to 35% in 2016. This indicates a 14% decrease in proportion of mainland family businesses who are inclined towards succession planning. The proportion of mainland family businesses that stated they have a succession plan this year is also lower compared to the Hong Kong (43%) and the global averages (49%).

• 58% of mainland respondents have next generation family members working in the business, compared to 71% in 2016. This indicates a 13 percentage point decrease compared to two years ago. This year, fewer mainland respondents also reported having next generation family members on their leadership team (35%), board of directors (29%) or senior management (33%) than the global averages. Globally, 43% reported having next generation family members on the leadership team, 37% on the board of directors and 36% in senior management.

• These downward trends suggest that family businesses are not adequately preparing to steer the company after the founder has stepped down. However, in terms of long-term goals over the next five years or longer, high proportion of family businesses on the mainland were more concerned with environmental sustainability (75%) and protecting the business as the most important family asset (62%). The data suggests a discrepancy between wanting to protect the business and failing to ensure business continuity.

• Fewer mainland and Hong Kong family business leaders cared about creating a legacy than their global counterparts (mainland: 25%, Hong Kong: 30%, global average: 60%). This is likely due to the fact that a higher proportion of family businesses on the mainland and in Hong Kong are first generation owned, compared to the global average, therefore less inclined to think about legacy (see Figure 20).
The implications of the findings for different stakeholders, such as family businesses, banks, governments/regulators, are as follows:

**For family businesses:**

- There is opportunity for family business owners that emphasise sustainability to invest their wealth consistent with their values by using environmental, social and governance (ESG) criteria for portfolio selection and investment analysis. However, in order to shift capital to socially beneficial activities, family businesses being asset owners need to familiarise themselves with existing frameworks for responsible investment.

- Mainland China is the fastest growing market for sustainable investing due to China’s growing interest in green finance and its policy commitments to curtail carbon emissions by 2030. According to a biennial survey by the Global Sustainable Investment Alliance, sustainable investments in mainland China grew six-fold to US $2.9 billion from 2014 to 2016, primarily related to clean energy.1 Family businesses being investors could ask themselves which other SDG problems they could be interested in solving through investment and whether they would be happier with a lower return as a trade-off for higher impact.

- From a risk management perspective, family businesses could consider exploring family governance mechanisms such as family constitution, family council and family committees, particularly in the area of conflict resolution.

- There is opportunity for family businesses to develop a succession plan that focuses on wealth preservation including setting up a trust fund or family office in addition to last will and estate planning. This is key to ensure their businesses survive and to build a lasting legacy.

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1 Global Family Business Survey 2018 – China Report
For banks and advisory firms:

- Institutions could prioritise offering indices and products suited to sustainable investing such as ESG-screened bonds, green bonds and sustainability screened equities and related ETFs, to name a few examples. Focusing on developing the complexity of products that are currently on offer and providing guidance around sustainable investing to meet the needs of their values-driven clients could be a start.

- Driven by the values-driven demand of Chinese asset owners, sustainable investing and impact investing is moving into the mainstream and there is significant market opportunity to be tapped by asset and wealth managers operating in China. There is a knowledge gap on what sustainable investing entails, as well as the return and impact it can deliver. Are the asset managers aware, which of the asset owners wouldn’t mind a lower return on their investments? If this gap can be bridged, this would help to further grow investor interest to increase allocations towards sustainable investing.

- Institutions could offer digitally innovative solutions to meet the needs of their digitally savvy customers particularly next generation digital natives. For example, a 2017 PwC report highlighted that a lack of digitally-enabled solutions has been cited by 36% of Hong Kong private wealth managers as one of the top 3 complaints they receive from clients. Therefore from a wealth management perspective, robo-advisers and FinTech solutions could be offered to meet family business expectations.

For governments/regulators:

- There is an opportunity for regulators to develop policies that support sustainable investing initiatives. It is heartening to see that the China Securities and Regulatory Commission aims to make it mandatory for all listed firms to disclose environmental impact information by the end of 2020, although there is still a lack of emphasis on social and governance aspects. It is also encouraging to see that the Securities and Futures Commission announced its strategic framework to contribute to the development of green finance in Hong Kong in late September.

- Wealth management is one of the most heavily regulated financial services sectors with clients having to comply with the tax jurisdiction in which they are based as well as with cross-border regulations. However, the government would need to reflect on what kind of regulatory and legal context would need to be promoted to encourage development of ESG driven investment vehicles

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i. According to Thomson Reuters, China leads the rest of Asia in terms of the size of the wealth management market, information technology and FinTech growth capabilities. Instead Hong Kong is seen to have a more complex regulatory regime which needs to become simpler, clearer and more transparent in order to attract new FinTech players.
Family businesses have a significant market presence in terms of job creation, contribution to the GDP and societal impacts. It is encouraging to see that family businesses are values driven with an eye to sustainability and longevity of their portfolios. China's momentum in impact and sustainable investments is moving into the mainstream and should be able to accommodate the market's demands as there is high level policy commitment on cutting down carbon emissions. As part of the ‘war on pollution’, China's policy makers have articulated new energy and environmental policies supporting renewables and stopping the construction of coal fired power stations between 2016 and 2020.\textsuperscript{7}

While influence of culture and values is strong in China, it can also make family businesses averse to conflict management. Managing differences is key to ensuring stability and longevity of the family business and is in most cases a proxy for quality of governance. Data also suggests inconsistency in that while family businesses want to ensure longevity, succession planning continues to be weak. Family businesses are experiencing strong growth in China and there is plenty of market opportunity for service providers in China to help them navigate their challenges and priorities. We encourage you to read the main report for insights on family businesses in China.
Introduction

In mainland China, a large number of private family enterprises were formed after the economic reforms in 1978. Since then, China has issued a series of policy measures to encourage and support the development of the private sector and the number of entrepreneurs have grown rapidly to 27 million as at the end of 2017, of which family businesses form the majority.\(^8\) The number of family businesses as a proportion of all private enterprises listed on the A-share market shows an increase from 48.9% in 2016 to 55.7% in 2017. As of April 2017, 1,112 family businesses are listed on the domestic stock market.\(^9\) In recent months, the government has also publicly encouraged the growth and innovation of privately-owned enterprises and SMEs. In addition to solving the problem of quasi-entry and financing, it will also introduce a higher-level and more effective tax reduction and fee reduction policy.\(^10\) For example, the Ministry of Finance will set aside a fund of 3 billion yuan each year from 2018 to 2020 to implement the reduction of corporate financing guarantee fees for SMEs through a combination of subsidies and incentives.\(^11\) The Guangdong provincial government also issued a notice offering certain financial incentives for private enterprises successfully listed on the New Third Board. Private enterprises that have successfully obtained direct financing from the issuance of convertible bonds or shares at the regional or provincial level will be granted certain financial subsidies.\(^12\) In Hong Kong, the top 15 family businesses controlled assets worth 84% of GDP in 2015.\(^13\)

\(^8\) Global Family Business Survey 2018 – China Report

\(^9\) Global Family Business Survey 2018 – China Report
Given the significance of family businesses in mainland China and Hong Kong, the PwC Global Family Business Survey interviewed 108 family businesses in the two territories covered (52 in mainland China and 56 in Hong Kong). Key decision makers were interviewed and the total sales turnover of the HK sample was US $11 billion and for the mainland China sample was US $19.5 billion. Every two years PwC conducts the survey globally to explore the trends in family businesses. The survey covers questions on the family business's values and purpose, performance and challenges, as well as preparations for the future. The 2018 Global Family Business Survey was conducted between April and August and surveyed 2,953 family businesses each with a sales turnover of above US $5 million across 53 countries.

For the purposes of this report, “China” refers to the People’s Republic of China, including Hong Kong survey respondents. Where there is a statistically significant difference in the survey results between Hong Kong and mainland China, results are presented separately.

In terms of sector distribution, manufacturing accounts for 25% of the sample in mainland China compared to 29% of the sample in Hong Kong. In the mainland China sample, technology (manufacturing) accounts for 29% of the sample and business activities account for 8%. In the Hong Kong sample, wholesale accounts for 16% and retail accounts for 14%.

Family businesses are experiencing a period of unprecedented complexity marked by economic, geopolitical and generational change. Companies are being evaluated by their emphasis on sustainability, being “in it for the long run”, and enhancing their bottom line, and family run firms are no exception. This is the China report which uncovers how family businesses on the mainland and in Hong Kong are navigating and thriving in this unpredictable environment.
Chapter 1
Growth through higher sales
Family businesses report higher sales growth

More family businesses on the mainland have seen higher sales growth over the past 12 months (75%) compared to the global average (69%). Out of this, 67% of mainland respondents saw double digit year-on-year growth in 2018, roughly double the global proportion of 34%. While mainland growth was in line with what it was two years ago, fewer firms this year reported a sales reduction as compared to 2016 (13% versus 27%). Conversely, Hong Kong family businesses are seeing lower growth levels than their global peers (although the figure has improved compared to 2016). 55% reported growth in the past 12 months (compared to 38% in 2016) and only 25% saw their business sales exceed 10%.

There is evidence from the global sample that double digit growth is correlated with having defined values. 84% of firms with double digit growth in the past 12 months have a clear sense of agreed values which compares to 76% of firms that report sales growth of less than 10%.

In aggregate, 26% of family businesses in China expressed “quick and aggressive” growth aspirations over a two year time horizon, compared to 16% of their global counterparts. On a dis-aggregated basis, 31% of mainland respondents expect to grow “quickly and aggressively” compared to 21% of Hong Kong respondents. In terms of “steady growth” aspirations over a two year time frame, comparable proportions of family businesses in HK and China (mainland: 52%, Hong Kong: 50%) shared this view compared to a global average of 68%.
The expectations of family members are to continue to operate, develop and expand this enterprise. Increase the share in the market.

(Second generation, Hong Kong)
Thinking about their business in two years’ time, 63% of mainland family business leaders will have made significant steps in terms of their digital capabilities, 58% will have brought in experienced professionals from outside the company to help run it and 48% will be selling their goods or services in new markets. These proportions compare favourably to the Hong Kong and global averages. 32% of Hong Kong respondents are investing in digitalisation (global average: 57%), 46% in professionalisation (global average: 53%), and 29% in geographic diversification (global average: 38%).

Around one quarter of respondents on the mainland will have significantly changed their business model (25%) or will earn the majority of revenues from new products or services (23%).
In terms of using internal versus external resources to finance growth, higher proportion of mainland and Hong Kong family business leaders relied on external resources whereas their global counterparts relied on internal resources for financing growth. Survey results showed that apart from relying on bank lending and credit lines, mainland family businesses used capital markets (69%), the stock market (63%) and venture capital or private equity (38%) to a much greater extent than their global peers. Hong Kong decision makers also took advantage of non-traditional funding methods to a greater degree particularly accessing the capital markets through bonds or debt issuance (25% versus 15% globally). On the other hand, lower proportions of family businesses in China compared to their global counterparts used internal resources for financing growth (mainland: 56%, Hong Kong: 54%, global average: 71%).

Looking at actions that they would consider to help fund the business, almost three-quarters (73%) of mainland family businesses will consider listing all or part of the business on a stock exchange or placing shares with chosen institutions. Hong Kong family business executives were also more inclined to turn to equity financing (45% compared to 26% globally) thanks to the establishment of the Growth Enterprises Market (GEM) and a more mature investor base. Over two-fifths (44%) of businesses in mainland China will consider bringing in private equity to help fund the business (global average: 39%).

Figure 4: Current and planned sources of funding for family businesses

<table>
<thead>
<tr>
<th>Source of Funding</th>
<th>Mainland China</th>
<th>Hong Kong</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank lending/credit lines</td>
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<td>63%</td>
<td>81%</td>
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<td>Capital markets</td>
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<tr>
<td>Stock market</td>
<td>63%</td>
<td>18%</td>
<td>10%</td>
</tr>
<tr>
<td>Internal resources</td>
<td>56%</td>
<td>54%</td>
<td>71%</td>
</tr>
<tr>
<td>Venture capital/private equity</td>
<td>38%</td>
<td>16%</td>
<td>16%</td>
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</tbody>
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Family businesses are active strategic planners

Brick-and-mortar businesses are being replaced with virtual organisations and changing consumer habits has meant that what worked in the past may no longer suffice. Against the backdrop of an ever-evolving playing field, the global data shows that having a mid-term strategic plan also correlates to double-digit sales growth. 55% of firms with double digit growth in the last year have a fully costed, formalised and documented strategic plan which compares to 46% of firms that report sales growth of less than 10%.

Close to all mainland family business executives have a strategic plan for the next three to five years (96% compared to 79% globally). The proportion that have fully costed, formalised and documented strategic plan also compares favourably with the global average (77% compared to 49%). In contrast, Hong Kong family businesses appear to be less prepared. Almost one-third of them have no strategic plan at all, higher than the global average (32% compared to 21%).
Among those with any sort of plan, 90% of mainland family business leaders say the plan is embedded in their financial planning process (Hong Kong: 63%, global average: 83%), and 70% say the plan has defined financial and non-financial KPIs in place to measure its success (Hong Kong: 39%, global average: 65%). 98% have communicated the plan internally (Hong Kong: 61%, global average: 82%) and 78% externally (Hong Kong: 45%, global average: 53%). Hong Kong firms appear to be lagging behind the mainland and global averages for these indicators.

In terms of short-term aspirations, executives on the mainland found that attracting and retaining talent (92%), being more innovative (85%) and offering a compelling reward system for employees (83%) were the most important objectives to pursue in the next two years. Hong Kong decision makers were also concerned with talent management (80%) and innovation (73%), yet on top of this, improving profitability was a key goal for 79% of respondents. These top three goals, talent management, innovation and profitability, match the priorities of their global peers. However, fewer Hong Kong respondents viewed contributing to the community, leaving a positive legacy as well as achieving a work-life balance as important goals. Merely 36% prioritised contributing to the community and leaving a positive legacy (mainland: 44%, global average: 60%) and 34% prioritised achieving a work-life balance (mainland: 69%, global average: 58%).

I would like my lasting legacy to be a basic principle of company management: appointing people on their merit and ability. It does not matter whether they are your relatives or your rivals.

(First generation, Mainland China)
Chapter 2
Challenges faced by family businesses
The pressing need to innovate

Mainland family business leaders cite the need to innovate in order to keep ahead as the key challenge that they face (77%). This worry exceeds their other perceived challenges by a significant margin. Over half see the economic environment (58%) and the lack of professionalisation of the business (52%) as issues. Hong Kong family businesses on the other hand view the economic environment as the biggest challenge to their business (64%). They are also concerned with domestic competition (55%) and the need to innovate (55%). A higher proportion of Hong Kong family businesses, than their mainland counterparts, worry about succession (30% compared to 12%) and conflict between family members (18% compared to 4%). A higher proportion of mainland businesses compared to Hong Kong businesses worry about data management (50% compared to 25%).

Figure 7: Key challenges for family businesses over the next 2 years

- The need to innovate to keep ahead: 77% (Global), 66% (Mainland China), 64% (Hong Kong)
- Economic environment: 58% (Global), 56% (Mainland China), 64% (Hong Kong)
- Professionalisation of the business: 52% (Global), 43% (Mainland China), 41% (Hong Kong)
- Data management: 50% (Global), 25% (Mainland China), 39% (Hong Kong)
- Domestic competition: 48% (Global), 48% (Mainland China), 49% (Hong Kong)
Family businesses on the mainland and Hong Kong tend to feel less vulnerable to digital disruption or a cyber-attack than their global peers perhaps as they have already embraced “going digital” to a greater degree. The digital economy was equal to 30.3% of mainland China’s GDP or 22.6 trillion yuan (US $3.35 trillion) in 2017 and is expanding rapidly. It includes the Internet of Things, financial technology, artificial intelligence, advanced robotics and big data.\(^{14}\)

Only 12% of mainland and 27% of Hong Kong executives feel “very vulnerable” or “fairly vulnerable” to digital disruption (compared to 19% and 33% in 2016 respectively). The global average of this statistic has instead risen from 24% in 2016 to 30% in 2018. The proportion of family businesses on the mainland that feel very or fairly vulnerable to a cyber-attack in 2018 amounts to 15% of the respondent sample whereas in Hong Kong it is 23% and the global figure is 40%.

When asked to elaborate on the threat from digital disruption, respondents are more likely to see it as a challenge to their existing business model and the need to keep up or stay ahead by having the right skill sets, leadership skills and investment. Family business executives on the mainland and in Hong Kong are worried about the emerging threat of competitors. These could take the shape of large multinationals challenging the way family businesses sell their products and disrupting the supply chain, or it could be new entrants that have the skills and funding to disrupt the market and have a digital focus from the outset.

Survey respondents in the global as well as in the China sample made reference to specific technologies that posed a competitive threat or impact on jobs. The consensus view was that artificial intelligence presented the biggest threat (based on the number of mentions). There were fewer mentions of Blockchain, big data, machine learning, 3D Printing and driverless cars for example. Some however saw these threats as opportunities or had a lack of understanding of the threat, interpreting it more as a security risk. There were mentions on significant fears over cyber security, vulnerability to cyber-crime, reputational threats from social media, banking fraud or systems outages.

“We are vulnerable to the disruption caused by artificial intelligence and new business models. AI may affect the direction of our product development. New business models may be based on the Internet of Things. Traditional manufacturing is based on two ends: the manufacturer and the client. We will become a link in the middle.”

(First generation, Mainland China)
Conflict management is still taboo

In spite of their best intentions, family members’ strategic directions may not always align. Conflict management is therefore an important aspect of ensuring productivity and business continuity.

23% of mainland and 29% of Hong Kong businesses state that family conflict has not occurred compared to the global average of 17%. Perhaps part of this is due to the fact that they are less likely to admit there is conflict in the family than their global peers due to traditional Confucian values that emphasise family unity. Many mainland family businesses tend to hide conflicts that occur among family members due to the strong desire to “save face” or uphold their reputation. In fact 13% of family business decision makers on the mainland and 14% in Hong Kong admit that they ignore conflict because of societal norms (global average: 9%).

For those Hong Kong businesses that do manage family conflict, 52% claim that it is handled within the immediate family (compared with global average of 63%) and 52% stated conflict is discussed openly by the family (compared to the global average of 54%). On the mainland, 60% reported handling conflict within the immediate family and half discuss it openly. 17% of mainland family firms use a third-party conflict resolution service compared to the global average of 14%.

According to a report by the World Economic Forum, conflict management is a key component of the governance practices of a family business. The same report indicates that family tension has a strong negative impact on performance, while the use of family governance practices enhances the firm’s financial success. In order to mitigate family conflict and promote unity, it is necessary for businesses to put in place a formal family governance plan. Incorporating structures such as a family constitution, family council and family committee for example, can go a long way to help to advance family harmony as well as business prosperity.

Because the amount of wealth involved in a family business is relatively large, using the enterprise family values determines many factors, including the business development and direction of the enterprise. Therefore, the values of the family must be clear. If it is not clear, it will be difficult when you encounter conflicts.

(First generation, Mainland China)
Diversity through female representation is lagging

In the past, mainland and Hong Kong family businesses usually gave preference to the first-born son in the family when handing over the business. However, attitudes are changing and more women are now being given equal rights to business ownership as compared to their male counterparts. That being said, the 2018 survey findings show there is still some way to go to achieve gender equality.

Mainland respondents reported a lower proportion of board members that are women (15%) than the global average (21%). Additionally only 15% of the next generation family members working in the business on the mainland are women (global average: 23%). Hong Kong family businesses were in line with their global peers in terms of the current levels of female senior management. On average 20% of board members (global average: 21%) and 25% of management are women (global average: 24%). However, only 9% of next generation family members in Hong Kong family businesses are female (compared to the global average of 23%).

Female talent and leadership is critical for businesses. According to a 2018 PwC report, the skills and experience women bring are essential in strategic decision-making and in building an ethical, sustainable enterprise. In a 2015 MSCI study, the return on equity was 2.7% higher for companies on the MSCI World Index that had strong female leadership and these companies were also less prone to governance-related controversies.
Chapter 3
Family and corporate values enhance reputation and sustainability
Values and purpose help family businesses navigate the challenges posed by the economic environment and digital disruption. Family businesses, like all corporations, are also under increasing scrutiny to promote sound corporate governance and ensure long-term sustainability. Survey results found that 71% of mainland family businesses have a clear sense of agreed values and purpose as a company compared to the global average of 79%. 87% of mainland family businesses are committed to corporate social responsibility (CSR) which is higher than the global average of 77% and 73% have a defined code of conduct which compares favourably with the global average of 66%.

When asked which key words represented their family values, mainland and Hong Kong family businesses, like their global peers, gave varying answers such as: community, ethics, sustainability, innovation, quality, customers and trust. Companies that have written down their family values and mission give richer and more detailed answers. They were able to better articulate their values thus providing evidence that the rigour of committing values to paper is a meaningful process.

Firms that have strong family and corporate values are more likely to run their business based on the principles of long-term stewardship and sustainability. From the global sample, results suggest that family businesses that display double digit growth are more likely to have defined values (see Chapter 1).

Those mainland family businesses with a clear sense of agreed values feel strongly that these benefit the company in a variety of ways, notably in terms of business reputation and increased sustainability (100% and 97% respectively). In mainland China the results suggest that values and purpose have helped to create a competitive advantage (94% versus 75% globally) and have impacted the bottom line in increased revenue and profitability (85% versus 70% globally).
Family values are similar to our company's values, that is, integrity and synergy, from a company perspective, this creates greater value for the company.

(First generation, Mainland China)

In the Hong Kong context, family business decision makers that have defined their values and purpose state these have had a positive impact on staff retention, business reputation, sustainability and creating a competitive advantage. This implies that family businesses that can live up to their values and purpose can make better decisions for the firm and mitigate against risk.

On the other hand, family and corporate values are inextricably linked to a family business's brand as these have a “visible” impact on the company’s ability to communicate with and service its customers. In fact, the importance of brands to reinforce company values and support quality economic growth has been underscored by recent government-led measures, including the establishment of the “China Brand Day” by the State Council, and CCTV’s “China Brand Project” promoting domestic brands with strong missions and social responsibility"
Chapter 4
Preparation to ensure legacy and business continuity
Practising philanthropy is a great way for family businesses to demonstrate and reinforce their company values and preserve legacy, while succession planning to pass on company leadership and management is key to business continuity.

Greater scope for philanthropy

By engaging with the wider community, the family-run firm shows their stakeholders that they are cognisant of the world in which they function. On the mainland, charitable giving by family businesses is still at a nascent stage. This might be due to the fact that the wealth is relatively new and family foundations have yet to be established to the degree that they have been in the West. Additionally, the governance of charities is weak and trust is low. However, as mainland family businesses mature, there is great scope for them to get involved in philanthropy in the future.

Among mainland and Hong Kong family businesses, a high proportion are engaged in some form of philanthropic activity and for most, this has a good cause or community focus (mainland: 77%, Hong Kong: 70%). When asked about engagement through other types of philanthropic activities, most popular was providing voluntary services to the local community (mainland: 69%, Hong Kong: 45%) followed by engaging employees in decision making about community service (mainland: 62%, Hong Kong: 50%).

Family businesses that are engaged in philanthropy use a variety of methods to ensure these activities happen including embedding it in the firm’s strategy (mainland: 50%, Hong Kong: 40%), incorporating it in corporate governance rules and articles of association (mainland: 50%, Hong Kong: 17%) or family governance (mainland: 25%, Hong Kong: 28%). Yet, businesses on the mainland hold themselves more accountable for their philanthropic actions. Close to seven in ten mainland businesses (68%) try to measure the impact of their philanthropy (much higher than the 26% in Hong Kong and 29% that claim to do this globally).

Figure 12: Family business engagement in philanthropic activities

Family businesses that are engaged in philanthropy use a variety of methods to ensure these activities happen including embedding it in the firm’s strategy (mainland: 50%, Hong Kong: 40%), incorporating it in corporate governance rules and articles of association (mainland: 50%, Hong Kong: 17%) or family governance (mainland: 25%, Hong Kong: 28%). Yet, businesses on the mainland hold themselves more accountable for their philanthropic actions. Close to seven in ten mainland businesses (68%) try to measure the impact of their philanthropy (much higher than the 26% in Hong Kong and 29% that claim to do this globally).

ii. According to a report by the United Nations Development Programme titled ‘Unleashing the potential of philanthropy in China’, philanthropy only contributed 0.17% to China’s GDP in 2014 whereas in the US it contributed 12%.

iii. According to the same report, as at the end of 2015, there were over 4,211 foundations in China, a 60 percent increase from just five years ago. The majority of these are corporate or family foundations associated with a company.
Fewer next generation family members are working in the business

Apart from the members involved in the day-to-day running of the business, it is critical to consider the wider family unit. In particular, to what extent is the next generation involved in the business and how much do they have a say in the way it is run?

Fewer mainland family businesses have next generation family members working in the business than two years ago (58% compared to 71% in 2016). This year, fewer mainland respondents also reported having next generation family members on their leadership team (35%), board of directors (29%) or senior management (33%) than the global averages. Globally, 43% reported having next generation family members on the leadership team, 37% on the board of directors and 36% in senior management. Comparatively, more Hong Kong family businesses have next generation family members working in the business than in 2016 (57% compared to 44% two years ago).

These discouraging statistics are supported by recent research from the Tanoto Center for Asian Family Business and Entrepreneurship Studies at the Hong Kong University of Science and Technology that finds that 80% of second generation heirs on the mainland have no desire to join their family business. Part of the reason why stems from the fact that they have been educated overseas and have adopted new career ideas. The low value added businesses they stand to inherit are viewed as less sophisticated than other ventures they could be undertaking in industries like banking, investment and technology.

In spite of this, more mainland next generation family members are engaged in a family office than their Hong Kong or global counterparts (mainland: 21%, Hong Kong: 5%, global average: 15%) or in philanthropic activities (mainland: 40%, Hong Kong: 14%, global average: 24%). Perhaps the next generation are more willing to take on these ancillary functions rather than critical parts of the business. Or it could be that first generation owners are more willing to hand over these secondary areas to their next of kin while retaining control of their primary operations.

It is important for family businesses to involve the next generation in the business not only to ensure succession but also as a means to tackle digital disruption. Millennials are well-educated digital natives that have a wealth of skills to offer in order to drive innovation and out-of-the-box thinking. By setting up a development program for next generation family members, business owners can empower them either to set up their own venture within the business or take the existing business to the next level.

iv. The likely reason for this is majority of the overall global sample of family businesses surveyed are more established companies (in their second generation or greater). The older the business is, the greater the number of generations that have been brought up in the business and therefore know how to run it.
Figure 13: Involvement of the next generation in the family business

<table>
<thead>
<tr>
<th>Role</th>
<th>Mainland China</th>
<th>Hong Kong</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>On the leadership team</td>
<td>36%</td>
<td>38%</td>
<td>43%</td>
</tr>
<tr>
<td>Senior executives</td>
<td>33%</td>
<td>34%</td>
<td>36%</td>
</tr>
<tr>
<td>On the board of directors</td>
<td>29%</td>
<td>27%</td>
<td>37%</td>
</tr>
<tr>
<td>Working in the business but not in a senior role</td>
<td>29%</td>
<td>21%</td>
<td>31%</td>
</tr>
<tr>
<td>Not working in the business but who are shareholders</td>
<td>10%</td>
<td>7%</td>
<td>29%</td>
</tr>
<tr>
<td>Engaged in family office</td>
<td>5%</td>
<td>15%</td>
<td>21%</td>
</tr>
<tr>
<td>Engaged in philanthropic activities</td>
<td>14%</td>
<td>24%</td>
<td>40%</td>
</tr>
</tbody>
</table>

More next generation family members on the mainland are expected to graduate from business school than their global counterparts (mainland: 70%, global average: 59%) and to have specific foreign language skills (mainland: 70%, global average: 50%). More next generation family members in Hong Kong on the other hand are expected to gain experience outside the family business than their global peers (Hong Kong: 75%, global average: 69%). Fewer mainland and Hong Kong respondents expect next generation family members to gain experience from inside the family business than the global average (mainland: 67%, Hong Kong: 69%, global average: 76%) or fulfil the official job specification of the role they assume (mainland: 53%, Hong Kong: 59%, global average: 65%). This suggests a level of nepotism still prevails in this part of the world possibly hindering the professionalisation of family businesses (earlier mentioned as a key challenge in Chapter 2).

Family businesses are less inclined to plan for succession

Perhaps the most important part of ensuring a lasting legacy is for family businesses to plan the succession process. However, mainland family businesses display a strong cultural resistance to discussing planning for death and succession.23 When it comes to handing over the reins fewer mainland respondents currently have a succession plan in place than those that did in 2016 (21% compared to 35%). The proportion of mainland family businesses that stated they have a succession plan this year also compares negatively to Hong Kong executives (43%) and the global average (49%). This may be explained by the observation that a higher proportion (75%) of mainland businesses surveyed are owned by first generation family members, compared to 55% in Hong Kong, thus are more averse to preparing for succession.

“Families are the compass that guides us. They are the inspiration to reach great heights, and our comfort when we occasionally falter.”

(First generation, Mainland China)
This year only 10% of mainland and 11% of Hong Kong family businesses have a robust, formalised and communicated succession plan in place (global average: 15%). Among those with no succession plan, 26% of respondents on the mainland plan to develop one compared to 38% of Hong Kong family businesses.

The need for a formal succession plan in order to enable an orderly succession in ownership, management and control cannot be overstated. Succession planning ensures the survival, ownership, and growth of the business among other advantages.

Figure 14: Family businesses with a succession plan

Mainland China
- 21% have a succession plan in place
  - 10% have a robust, formalised and communicated plan
  - 11% have a plan but less formal

Hong Kong
- 43% have a succession plan in place
  - 11% have a robust, formalised and communicated plan
  - 32% have a plan but less formal

Global
- 49% have a succession plan in place
  - 15% have a robust, formalised and communicated plan
  - 34% have a plan but less formal
When asked if they plan to pass on company leadership and management, ownership, or both, to a next generation family member, mainland and Hong Kong family business decision makers were less enthusiastic than their global counterparts. 42% of mainland respondents and 45% of Hong Kong respondents stated they would be willing (global average: 57%). In 2016, 62% of mainland respondents and 69% of Hong Kong respondents were willing to pass on company management, ownership or both, to a next generation family member (global average: 73%).

The emotional attachment that first generation owners have to the businesses they have created may form part of the reason they are unwilling to let go. Another reason could be the lack of interest from the next generation themselves. As mentioned earlier, mainland heirs are likely to have been educated overseas and come back opting for alternative careers in other industries. It also may be due to the fact that there are fewer next generation family members working in these businesses in the first place, therefore there is a smaller pool to choose from. In spite of this, when looking at those respondents who already have the next generation working in the business, the proportion of respondents willing to pass on company management, ownership or both, to a next generation family member, rises to 53% on the mainland and 69% in Hong Kong this year (global average: 68%).

For mainland family businesses that hope to pass on company leadership and management, company ownership, or both to the next generation, 33% plan to do so in the next ten years or later. The most popular timeframe for Hong Kong businesses on the other hand is within six to ten years (40% chose this option). Surprisingly, 29% of business leaders on the mainland reported that next generation family members were not even aware of these preparations (on par with the global average of 30%). Hong Kong family businesses were even less open in terms of disclosing their succession plans than their mainland counterparts. 36% stated they had not involved the next generation in the succession planning process.

“For the next generation, I want them to have freedom. I don’t mind whether they want to succeed in the family business or not. I want them to have their own way of life.

(First generation, Mainland China)”
Protecting the business as the most important family asset is key

Research by the Chinese University of Hong Kong finds that Asian family firms lose 60% of their value when the power is first transferred. From passing down business knowledge to future generations, to making a permanent impact on the community and society at large, it is crucial for family businesses to build a legacy that lasts long after the current leadership has stepped down.

In terms of long-term goals over the next five years or longer, businesses on the mainland were more concerned with environmental sustainability (75%) and protecting the business as the most important family asset (62%). In Hong Kong, like their global peers, the top two concerns were protecting the business as the most important asset (57% compared to 76% globally) and ensuring that the business stays within the family (55% compared to 61% globally). Fewer mainland and Hong Kong family business leaders cared about creating a legacy than their global counterparts (mainland: 25%, Hong Kong: 30%, global average: 60%). This is likely due to the fact that a higher proportion of family businesses on the mainland and in Hong Kong are first generation owned compared to the global average therefore less inclined to think about legacy (see Figure 20).

Yet for those mainland and Hong Kong family businesses who did care, when they were asked what they wanted their lasting legacy to be they emphasised continuity and endurance. Like their global peers, they have hopes that the physical business, family involvement, growth and success of products and services, and the support given to communities will last long beyond their lifetimes. Many family businesses defined success not just in terms of financial wealth but in less tangible elements of personal growth or development, community or employee support and the upholding of core values.

I would like to create a business that is sustainable in itself and be respected by customers and competitors while creating a stable yet challenging environment for employees to grow and advance in their career and to create a stable income stream for the extended family.

(First generation, Hong Kong)
Conclusion

Family and corporate values enhance reputation and sustainability. More mainland Chinese family businesses have a clear sense of company values than their Hong Kong peers. More have also achieved higher growth levels than their Hong Kong counterparts. These firms are still relatively young and many plan to grow quickly and aggressively in the next few years.

Privately-owned businesses are also currently being supported by favourable government policies. In September 2017, the Communist Party of China Central Committee and the State Council jointly released a guideline encouraging entrepreneurship in a move to drive market confidence. Mainland China’s 19th Party Congress report from October of last year also called for “supporting the growth of private businesses” and getting rid of regulations and practices that hamper the development of a unified market and fair competition.

In the longer term however, fewer mainland family business owners are inclined to plan for succession compared to two years ago. What’s more, fewer next generation family members are taking up roles in the family business than in 2016. With more than 3 million entrepreneurs reaching the age of retirement in the next decade, their businesses will no doubt face succession challenges. These challenges will be further exacerbated against a backdrop of digital disruption and a shortage of available talent.

There is an old Chinese proverb that states that “wealth does not pass beyond three generations”. Whether or not mainland and Hong Kong family businesses get handed over to next generation family members, owners are likely to look to external sources for professional advice and expertise in family governance and wealth management and preservation.

We offer three key recommendations for mainland and Hong Kong family businesses to thrive in the 21st century:

• Define and activate your company values, innovate and invest in digital capabilities and diversify your operations.
• Preserve your wealth through sustainable investing to protect and enhance portfolio returns over the longer term.
• Seek advice on family governance and succession planning and build a robust, formalised and communicated succession plan.

The company owner regards the company as his child and has brought it up. He has a strong sense of responsibility for the company and would like his lasting legacy to be a well-developed company. (First generation, mainland China)
Methodology and sample composition
For the purposes of this survey, a ‘family business’ is defined as a business where:

1. The majority of votes are held by the person who established or acquired the firm (or their spouses, parents, child, or child’s direct heirs);
2. At least one representative of the family is involved in the management or administration of the firm;
3. In the case of a listed company, the person who established or acquired the firm (or their families) possess 25% of the right to vote through their share capital and there is at least one family member on the board of the company.

Figure 17: Distribution of samples by sales turnover (US$)

<table>
<thead>
<tr>
<th></th>
<th>Mainland China</th>
<th>Hong Kong</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>$51-100m</td>
<td>6%</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>$21-50m</td>
<td>17%</td>
<td>14%</td>
<td>19%</td>
</tr>
<tr>
<td>$101-500m</td>
<td>8%</td>
<td>4%</td>
<td>5%</td>
</tr>
<tr>
<td>$10m and under</td>
<td>21%</td>
<td>18%</td>
<td>12%</td>
</tr>
<tr>
<td>$11-20m</td>
<td>29%</td>
<td>36%</td>
<td>24%</td>
</tr>
<tr>
<td>$1bn+</td>
<td>6%</td>
<td>6%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Figure 18: Distribution of Mainland China sample by sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>Mainland China</th>
<th>Hong Kong</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technology (manufacturing)</td>
<td>29%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business activities</td>
<td>8%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Retail</td>
<td>6%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Education &amp; health</td>
<td>6%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Food &amp; drink (manufacturing)</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Media &amp; entertainment</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Automotive and repairs</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
</tr>
</tbody>
</table>

Distribution of Hong Kong sample by sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>Mainland China</th>
<th>Hong Kong</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>29%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail</td>
<td>16%</td>
<td>14%</td>
<td>11%</td>
</tr>
<tr>
<td>Real estate and renting</td>
<td>14%</td>
<td>11%</td>
<td>8%</td>
</tr>
<tr>
<td>Financial services</td>
<td>5%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Transport</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Business activities</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Technology (manufacturing)</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
</tr>
</tbody>
</table>

Distribution of Global sample by sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>Mainland China</th>
<th>Hong Kong</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>22%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food and drink (manufacturing)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td>7%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail</td>
<td>7%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transport</td>
<td>4%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technology (manufacturing)</td>
<td>4%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 19: Distribution of samples by family ownership structure

<table>
<thead>
<tr>
<th>Ownership Structure</th>
<th>Mainland China</th>
<th>Hong Kong</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>One dominant owner</td>
<td>8%</td>
<td>12%</td>
<td>6%</td>
</tr>
<tr>
<td>Spouse and/or in-law</td>
<td>4%</td>
<td>17%</td>
<td>4%</td>
</tr>
<tr>
<td>Siblings</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Several cousins</td>
<td>2%</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>Extended family (30+)</td>
<td>8%</td>
<td>7%</td>
<td>4%</td>
</tr>
<tr>
<td>Other</td>
<td>17%</td>
<td>27%</td>
<td>28%</td>
</tr>
</tbody>
</table>

Figure 20: Distribution of samples by number of generations owning or running the business today

<table>
<thead>
<tr>
<th>Generations</th>
<th>Mainland China</th>
<th>Hong Kong</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 generation</td>
<td>21%</td>
<td></td>
<td>10%</td>
</tr>
<tr>
<td>2 generations</td>
<td>75%</td>
<td>55%</td>
<td>37%</td>
</tr>
<tr>
<td>3 generations</td>
<td></td>
<td>7%</td>
<td>3%</td>
</tr>
<tr>
<td>4+ generations</td>
<td></td>
<td>8%</td>
<td>6%</td>
</tr>
</tbody>
</table>
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Endnotes

17. Why more Chinese women are taking over the family firm or starting their own business, November 2017, https://www.scmp.com/business/companies/article/2118477/why-more-chinese-women-are-taking-over-family-firm-or-starting
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