

TAKING OVER THE MANTLE: SRI LANKAN FAMILY BUSINESSES TODAY

A STAX REPORT

IN COOPERATION WITH THE SRI LANKA
INSTITUTE OF DIRECTORS





ACKNOWLEDGEMENTS

SURVEY DESIGN, ADMINISTRATION & ANALYSIS

SEYEDA MOWHIBA, BUSINESS ANALYST (STAX)
DINUKA NICHOLS, STATISTICAL ANALYST (STAX)
INDIKA JAYASINGHE, MANAGER (STAX)

INTERVIEWS, CONTENT AND DESIGN

PIYUMI KAPUGEEKIYANA, PH.D.,
SENIOR CONSULTANT (STAX)

COORDINATION & EVENT ORCHESTRATION

CHAMINDĀ DE SILVA, CEO (SLID)



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FOREWORD

A family business is like a double-edged sword. Driven by emotion, these organizations have a deeper purpose beyond the nuts and bolts of business—they are full of soul. In Sri Lanka, family businesses have long underpinned corporate and social life; persevering past the war-torn years all the way through to the economic resurgence we now experience.

Equally though, the very bonds that cohere family firms in a common purpose can also prove corrosive if they are not managed properly. Globally, family businesses face similar challenges—complacency over time, family disputes, transitional issues across generations, ambiguity in structures and processes, amongst others.

As I see it, Sri Lankan family firms stand on the cusp of a phenomenal opportunity as the region expands. Most of these firms are now managed by 2nd and 3rd generation family members who have an unprecedented advantage in terms of global education and exposure. These generations are raring to go!

However, there is a short window to capitalize on the opportunities that dot the horizon; from overseas expansion to product diversification. Today's businesses need to think big and act fast in order to fulfill their responsibility to the economy and make their mark on the nation.

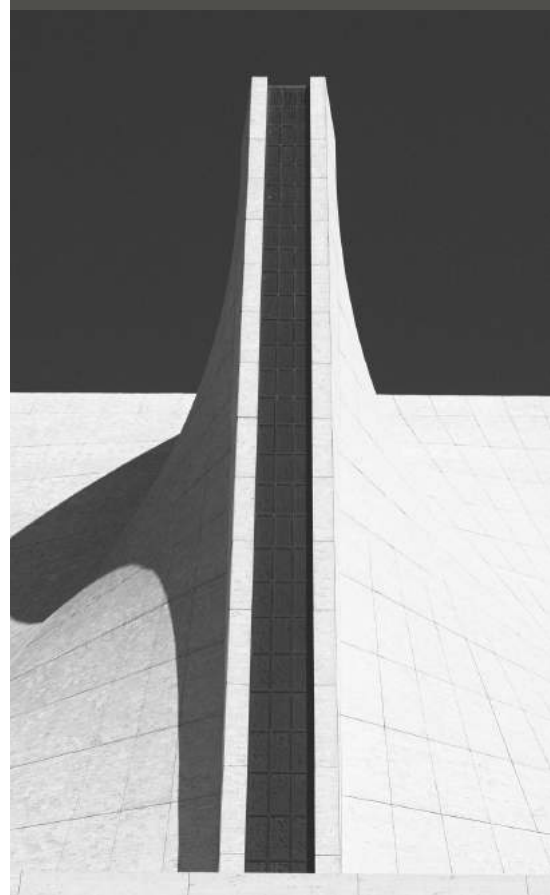
This is why it gives me great pleasure to share the findings of our first ever survey of local family businesses, carried out by STAX in cooperation with the Sri Lanka Institute of Directors. This report gives us the low-down of the strengths, challenges and experiences of Sri Lankan family firms today. In sharing these findings, our goal is to help family businesses build clarity, comfort and capability—to understand the opportunities and threats that confront them in order to capitalize or mitigate accordingly.



Ruwindhu Peiris
Managing Director
STAX

**"OUR GOAL IS TO HELP
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BUILD CLARITY,
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**-- RUWINDHU PEIRIS, MANAGING
DIRECTOR, STAX**



THE BONDS THAT UNITE: GLOBAL PICTURE

What is it that makes a family business unique?

An astute observer might speculate about everything from the trust inherent in familial relationships to the availability of pooled resources. Although the reasons may vary, there is no denying the socioeconomic influence and philanthropic reach of these firms.

Family businesses account for two-thirds of all firms around the world and contribute to an estimated 70%–90% of global GDP annually. These institutions serve as engines for employment creation, contributing 50%–80% of jobs worldwide. Family firms also tend to be amongst the biggest givers—often supporting philanthropic activities in their respective communities.

In China, ~85% of private enterprises are family owned. In Europe, they represent ~60% of all companies. In the Middle East, ~80% of businesses are family-run or family-controlled. In India, these companies account for at least two-thirds of GDP and ~90% of gross industry output. In the U.S. over half of all publicly listed companies are family-owned.

Clearly, family entrepreneurship is pervasive enough that we should sit up and take notice.

CHALLENGES PERSIST

On the flip side, it's not all smooth sailing. Although family businesses hold immense potential, they also encounter their own set of challenges around longevity and conflict resolution.

In 2016, 43% of global family firms did not have a succession plan in place, with only 12% making it to a 3rd generation. Moreover, 52% of next generation family business leaders are concerned that they will need to spend time managing family politics, with 61% of next gens worrying that it would be difficult for the incumbent generation to fully let go of the reins.

Even so, 88% of next-gen leaders also want to leave their stamp and do something special with the business.

In this report, we start off with a quick look at STAX's 6C framework for enabling sustainable family businesses. We also take a granular look at how Sri Lankan family firms perform on key areas; identifying focal issues for leaders to consider.

**THIS REPORT EXPLORES
4 KEY THEMES THAT
LEADERS NEED TO
CONSIDER FOR THE
LONGEVITY OF THEIR
FAMILY BUSINESSES:**

**STRATEGIC THINKING,
SUCCESSION PLANNING,
PROFESSIONALIZATION
AND INNOVATION.**



THE 6Cs FRAMEWORK

A STAX approach to enabling sustainable family businesses

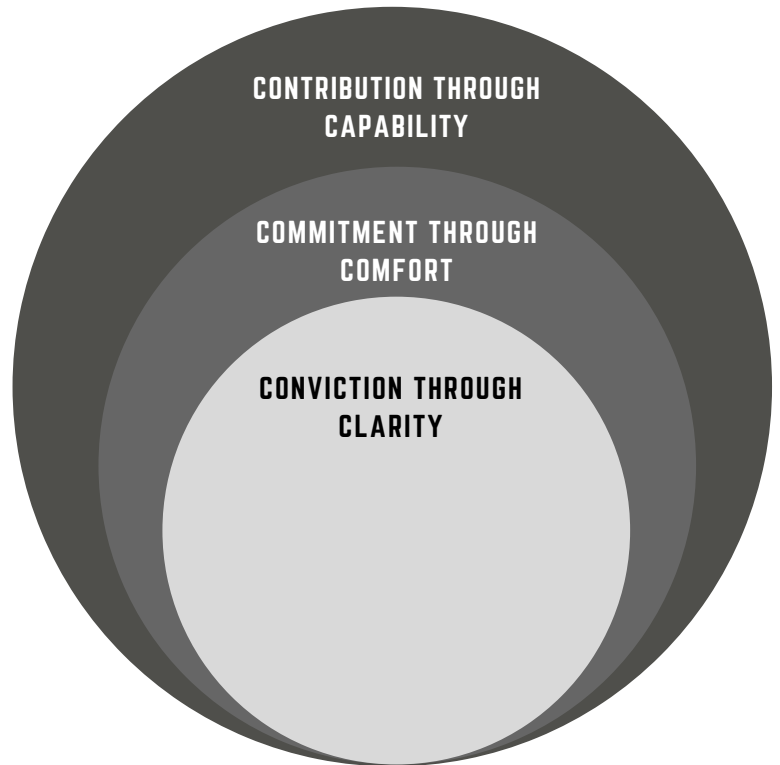
When interacting with family businesses across generations, STAX discovered early on that it would be essential to understand the needs of multiple, interdependent groups in order to avoid conflicts and ensure long-term success.

In the process of dealing with various stakeholders, family business leaders need to consider the following questions periodically:

- Are they Convinced?
- Are they Committed?
- Are they Contributing Optimally?

In our experience, businesses under-perform when there is a lack of Conviction. Commitment and Contribution from key stakeholders.

To address this issue in family businesses, STAX developed the 6C Framework aimed at bolstering Clarity, Comfort, Capability.



CONVICTION THROUGH CLARITY



To be **Convinced** on ideas and execution, people need **Clarity** on business goals, investment plans and decision-making

COMMITMENT THROUGH COMFORT



To be **Committed** towards business success, people need to have a sense of **Comfort**, which comes from being valued, informed and having their expectations managed.

CONTRIBUTION THROUGH CAPABILITY



To **Contribute** optimally, people need to unlock **Capability**, which requires assessing competence and stepping up training and development.



PULSE CHECK

A Snapshot of Sri Lankan Family Businesses in 2017

STRENGTHS

CHALLENGES

77% HAVE A WELL-DEFINED VISION OR ARE WORKING TOWARDS ONE

32% DO NOT HAVE A SUCCESSION PLAN

61% HAVE A 5-10 YEAR STRATEGY

35% LACK RESOURCES & CAPABILITIES FOR GROWTH

1 IN 2

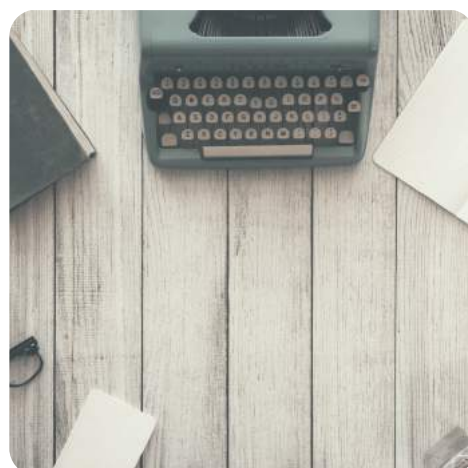
2ND GEN FIRMS DO NOT HAVE A LONG-TERM STRATEGY

64%

MAKE INVESTMENT DECISIONS ON SHORT-TERM OR AD-HOC BASIS

74%

DO NOT HAVE RISK MANAGEMENT STRATEGIES



87%

HAVE CONSIDERED DIVERSIFICATION



94%

WANT TO BRING IN SENIOR EXPERTISE FROM OUTSIDE THE FAMILY

FAMILY BUSINESS SURVEY



DEFINITION & FOCUS AREAS

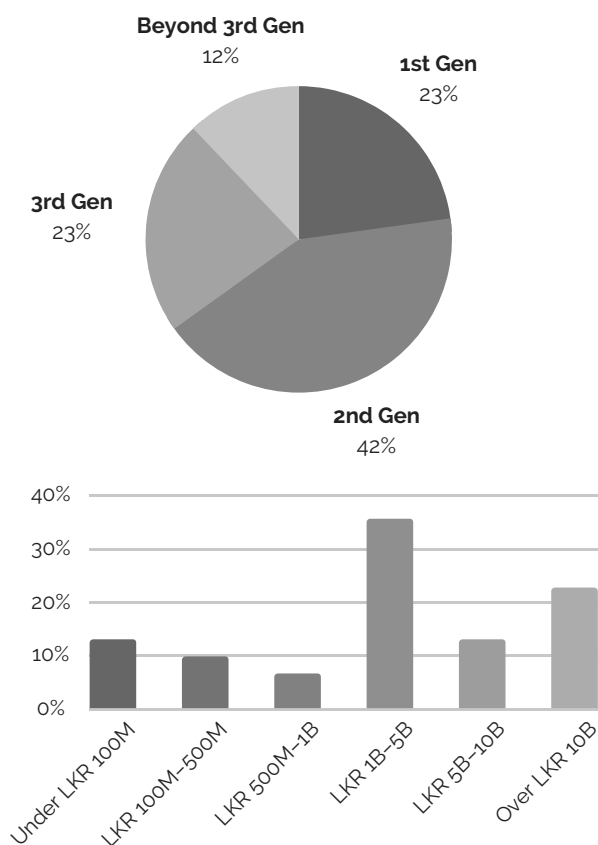
This survey defines family businesses as those firms in which multiple members of the same family are involved as major owners or managers, either contemporaneously or over time (Miller et al, 2007).

Using this broad definition enabled the documenting of a range of experiences and outlooks.

Survey questions were structured around 4 key areas: Strategic Thinking, Succession Planning, Professionalization and Innovation.

RESPONDENT SNAPSHOT

Survey responses were gathered during January–April 2017 and follow-up interviews were conducted in June 2017.



31 leaders surveyed



9 in-depth interviews



~20% are publicly listed or in the process of listing



~70% of family firms surveyed have been in existence for 30+ years

STRATEGIC THINKING

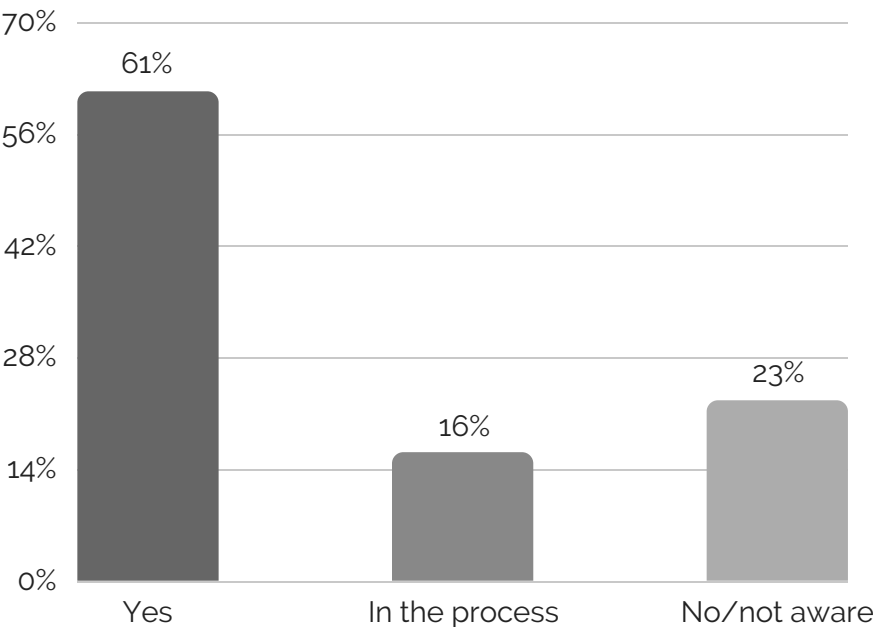
Strategic thinking—whilst essential for the sustainability of any business—is crucial for family firms, where the tendency towards myopic decision-making can be heightened by competing family interests. As most leaders soon discover, a clear vision is the cornerstone of any strategic roadmap .

Positively, our survey revealed that a combined 77% of family businesses either have a well-defined vision or are in the process of developing one. On the flip side, only 58% of companies have documented their vision in writing—the rest rely upon a verbal agreement.

A failure to articulate the vision of the business in writing can be especially problematic as a company transitions from the 1st Generation to the 2nd because the underlying goals are no longer as clear as they once were.

A cohesive vision is also important for family businesses that have diversified since their inception and are now dealing with a multiplicity of growth pathways, investment decisions and stakeholders.

Does your company have a well-defined vision?



Is the vision well-documented?



42%
ONLY HAVE A VERBALLY
AGREED VISION

Clarity of Vision Matters

"The people who started the business know exactly why they did it. In the second generation onward, the vision is not as clear as in the first."

—2nd Gen Electric Power Tools Supplier

"We have a group of companies across several diversified sectors and each of them has a vision. Some are detailed but others are less so. As a group, we now need to figure out the landscape of where we'll be in the next 3 years."

—2nd Gen Consumer Products Firm

Thoughts on Strategic Planning

"We're in insurance brokering. So we do have a plan in terms of going out and getting business. But we don't have a strategic roadmap. The reason is that for the last 30 years, the company was run by both father and daughter and they've always been able to manage the direction of the business between them. However, two external directors joined the company last year. As such, a strategic plan is now essential for direction and focus in the future."

—2nd Gen Insurance Broker

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"The challenges with strategic planning start with ownership. At what stage do we embark on it and do we include the initial founders? There may be people pulling in different directions. Another challenge is that different people in a family business have varying risk appetites and it's difficult to take a rational decision on investments and the intended level of growth."

—2nd Gen Electric Power Tools Supplier

While the vision provides the long-term focus for the business, a strategic roadmap provides direction on how the company will achieve or maintain its vision. Problematically, 39% of firms are yet to embark upon a strategic planning exercise for the future. Moreover, at the 2nd Generation level, nearly 1 in 2 firms have not given any thought to the strategic direction of their business.

Is there a clearly defined and actionable 5–10 year strategic roadmap for growth?



During our in-depth interviews, some companies attributed the delay in formulating strategy to a perceived lack of need—especially where there was a long history of close-knit, family-run operations with little or no external professional involvement.

In particular, small companies that had long been managed by only family members tended to hold the view that a formal strategic roadmap was only necessary when the company expanded and took on board new external hires. Until then, these firms were content to operate on the basis of a shared understanding between family members.

Even where family businesses acknowledged the importance of strategic planning, leaders lacked clarity around when to embark on such an exercise, whom to include, and how to resolve the conflicts that arise as a result of competing interests.

Several leaders reported that they had found independent consultants to be a useful resource when prioritizing between resources and strategies.

Have the leaders considered diversification for growth?



When contemplating the future, the majority of businesses have considered diversification as a key strategy for growth.

However, only a handful of firms reportedly make their investment decisions in accordance with their long-term strategic plan.

Instead, over 64% of players make investments based on short-term business plans or on an ad-hoc basis, indicating that current actions don't always support the long-term vision and may even be more on the reactionary side.

Some leaders continue to espouse the importance of sustaining the core identity of the business even as new opportunities are pursued.

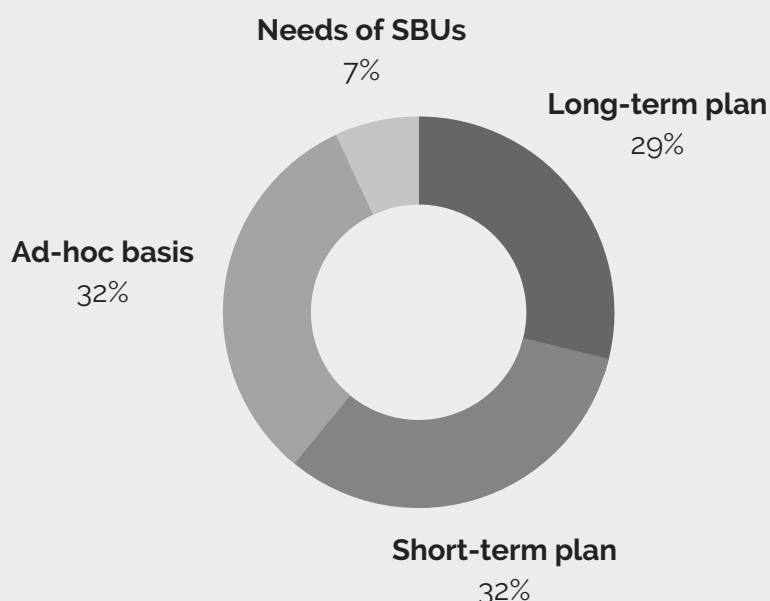
In essence, diversification should not transpire at the expense of what the business does best.

Core Identity is Integral

"My advice is to work within your strengths and take precautions not to lose your primary identity. Stay on road of what you know best but identify opportunities that are unique and uncharted."

—1st Gen Food Ingredients Importer

What are the company's investment decisions based on?



Mismatches in the alignment between a family firm's investment decisions and long-term strategic plans may be attributed to a number of factors including macro-level concerns like political instability and systemic issues like the absence of guidelines to regulate decision-making.

In some cases, principal-agent problems may also be to blame, insofar as the business is managed by agents external to the family, who are driven by short-term concerns.

Nearly 91% of family businesses do not currently perceive a lack of finance to be a limitation on growth—a seemingly rosy picture. However, our experience suggests that this optimism is more likely a consequence of firms reinvesting their earnings in relatively conservative plans for the future. In essence, most family firms do not perceive a shortage of finance to be an issue because they are not stretching to reach new and challenging targets.

Comparatively, family firms that are considering ambitious avenues such as overseas expansion observe that their retained earnings are no longer sufficient to fund growth. These firms report a greater willingness to look towards lucrative alternatives for raising funds. In this sense, finance is more likely to become a pivotal consideration as family businesses move to 'think big and act fast'.

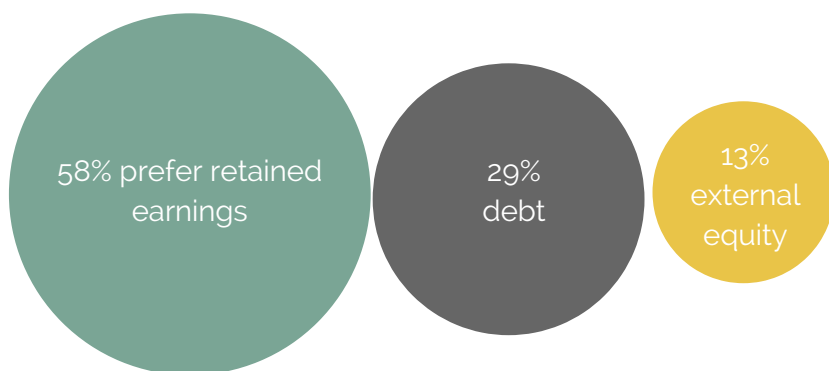
Is shortage of finance a key issue that might inhibit growth?

9%
**THINK THAT FINANCE
 MIGHT BE AN ISSUE IN
 FUTURE**



Even so, reinvesting retained earnings remains the most common and popular means of funding growth—followed by the use of debt financing and encouraging external investment for a share of equity. Comparatively, options such as private equity and venture capital are both less recognized and pursued.

How does the business plan to fund growth?



Leaders are on the lookout for competitive financing

“Five years ago, when we were not so diverse, we didn’t look at any investments. Moreover, what we earned was good enough for the business to grow. But in the last 5 years, we’ve really grown and have a need for a lot of capital. What we’re making is not enough to go forward.”

—2nd Gen Consumer Products Firm

“With the typical family business, there may be a lack of understanding. I don’t think they can easily delve into private equity or venture capital. Most businesses are familiar with banks. There’s definitely room to consult further in the area.”

—2nd Gen Electric Power Tools Supplier

The War for Talent Persists

"The biggest challenge now is finding the right human resources. Anyone with a degree wants to work for a branded company. Comparatively, we're not a very well-known company so people are sometimes scared to join us. From inception, we've focused our efforts on back-office operations. That's the part we must get right. From 2017 onward however, we're slowly going to start moving into the front office. In 5 years, there will be a different level of brand awareness."

—1st Gen Poultry Producer

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"Capacity building is minimal in Sri Lanka. To move past this, we need to develop a culture of R&D."

—1st Gen Cloud-based Solutions Company

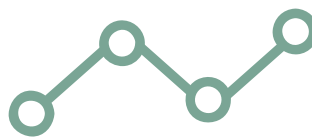
Does the business have the resources and capabilities necessary to support future growth?



35%

LACK RESOURCES & CAPABILITIES FOR GROWTH

The Top 3 Threats Confronting Family Businesses



1

POLITICAL INSTABILITY



2

INCREASED COMPETITION



3

WAR FOR TALENT

Our conversations suggest that family business leaders are well-attuned to the threats that confront them. Even so, the majority of these firms are yet to develop a structured approach to mitigating these challenges. It appears that risk management takes place on a more informal basis, rather than as a systematic and institutionalized process.



74%

DO NOT HAVE RISK MANAGEMENT STRATEGIES

SUCCESSION PLANNING

Our survey assessed succession planning to identify the readiness of Sri Lankan businesses to address issues relating to generational transfer. Globally, this has been an important focus area—if handled the wrong way, issues pertaining to succession are the likeliest to bring both personal and professional domains into conflict, placing both the firm and the family at risk.

The majority of family businesses reported that they had a succession plan that satisfied their aspirations. However, some leaders are yet to develop a sense of clarity and comfort regarding the extent to which the next-generation will contribute towards the business.



32%

DO NOT HAVE A
SUCCESSION PLAN



89%

ARE GROOMING THE
NEXT GEN FOR ROLES
IN THE BUSINESS



65%

ARE UNSURE IF THE
NEXT GEN WILL JOIN
THE BUSINESS

Given the challenges, family businesses see value in working with independent consultants to refine their succession plans and ensure continuity of the business and the family name.

"We just finished a family council with a consulting firm, which gave us a lot of clarity about how to do succession planning right. Through this, we cleared a lot of problems, including what kind of role the family will play in the business. I think this type of exercise should be mandatory.

—2nd Gen Consumer Products Firm

Incumbent generations increasingly require successive generations to gain external exposure before joining the family business.

External Work Experience is Valued

"Get your second generation to work outside the family business for some time—preferably at an MNC. Let them get outside experience and then adapt this in the family business."

—2nd Gen Electric Power Tools Supplier

"In order to run a family business, you've got to understand how it works and where it's headed. For that, you need some external experience. Otherwise, you'll have ownership of the asset and won't know what to do with it. It's like having a gold mine but not knowing how to dig for gold. What's the value in that?"

— Beyond 3rd Gen, Diversified Conglomerate

PROFESSIONALIZATION

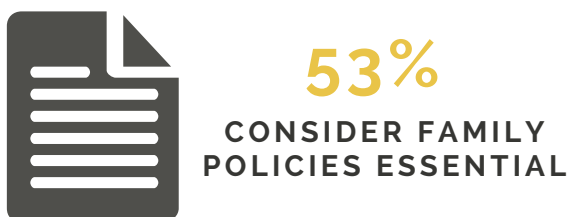
The act of professionalizing involves achieving a separation between family ownership and business management; often by hiring senior managers from outside the family and providing them with clear performance indicators, lines of responsibility and guidelines for daily operations.

While family businesses can be slow to embark on this process, professionalizing can free up valuable time and space for family members to think and plan more strategically; paving the way for a healthier business environment in the long run.

One of the pre-requisites for professionalization is a separation in business and family goals. However, the majority of family businesses neither have separately defined goals nor have given this area much thought.



Despite the general lack of separation between these two types of goals, ~71% of businesses agree that business goals should nonetheless take precedence over family goals in the event of a conflict. Many also find family employment policies helpful in gaining clarity about employment and conflict resolution.



Positively, the majority of firms are willing to bring in external expertise, with the key reason being a perceived need for greater diversity and maturity among leadership teams.



On recruiting externally

"We see value in recruiting outsiders and not depending on family alone, especially when there is no one in the pipeline who can join immediately. Of course, there's always the fear that outsiders may drop the ball. But on the flip side, failing to hire externally means that the family gets bogged down on the operations side and does not have much time to think about the future or the strategic side of things."

—2nd Gen Bulk Tea Exporter

The value of a constitution

"As the second generation gets involved, it's important to go through a structured process. Our new constitution for the next generation involves them working outside the company for 5 years and then within the business for at least 2 years before taking up a management position."

—2nd Gen Consumer Products Firm

Family tensions may arise...

"Traditionally, there is this question of wanting the family to continue. Sometimes, the risk is that you will limit professional management by giving key positions to family members who may not be qualified. The issue is that some people like titles for recognition in society. These are aspects of Asian culture and it requires some forward thinking to get out of these clutches."

—Beyond 3rd Gen, Diversified Conglomerate

...but the results from hiring externally are worth it

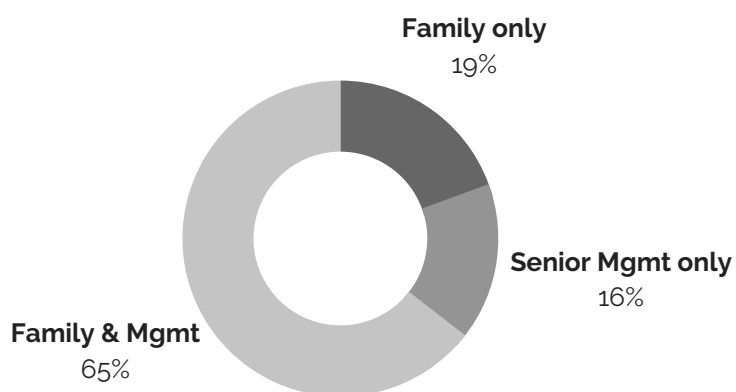
"We have invited 3 outside directors onto the board. Important decisions such as investments in machines are vetted by them. This works well because they take an angle we don't, such as the financial implications of a decision."

—3rd Gen Tea Exporter

In some cases however, the generations that follow the founder may insist on running the company even though they are not suited for the job. Moreover, as the number of family shareholders increases with each generation, new vulnerabilities can potentially arise—from genuine conflicts around remuneration and individual contributions, to issues like the misappropriation of funds for personal use.

In a family business that has been professionalized, there will ideally be some checks and balances on abuses of personal power. Moreover, key decisions are more likely to be made in collaboration with senior management and in accordance with procedures and guidelines. Many Sri Lankan family firms appear to be performing well in this regard.

Who is involved in key decisions in the company?



How are investment decisions made?



81%

**MAKE INVESTMENT
DECISIONS IN
ACCORDANCE WITH
GUIDELINES**

"Expansion drives a family business to professionalize. Unless the owners have real expertise, my advice is for the family to own the business but hire external management to run the company. Create a shared vision and give managers clear KPIs. The right time to achieve this division between ownership and control is when you've set up the engine and put it on track —when you're confident that your people can run the business."

—2nd Gen Insurance Broker

INNOVATION

We also assessed the willingness of family businesses to innovate and invest in technology. It is no secret that a company's ability to innovate—whether in terms of people, processes or tools—differentiates them from the competition.

Sri Lankan family businesses reportedly perform well in this area and the vast majority (95%) do not consider technology to be a growth inhibitor.



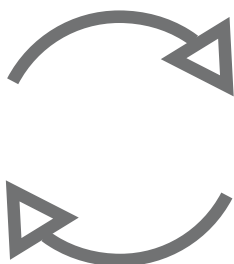
81%

**FOSTER NEW IDEAS
AND INVESTMENT
OPPORTUNITIES**



76%

**REWARD
SUCCESSFUL
IDEAS**



87%

**LEVERAGE TECH
FOR OPERATIONAL
IMPROVEMENT &
PRODUCT
DEVELOPMENT**

One of the main caveats sounded by leaders pertains to how plans for innovation need to be considered against potential limitations in resources and the broader business environment.

"For a family business upstart, the mistake is to think 'we can be big' without realistically looking at capacity and finances. It's better to start with small applications. Whatever you develop has to work within the environment in Sri Lanka."

—1st Gen Cloud-based Solutions Company

Forward-thinking family businesses find ways to integrate tech

"Technology is the way forward. Take payment gateways and the idea of a cashless society. In this field, we have tea auctions with online catalogs where foreign buyers can place a bid and pay online as well."

*—Beyond 3rd Gen,
Diversified Conglomerate*

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"We're predominantly a trading organization so inventory management systems become critical. Likewise, technology becomes important for marketing and promotions, with social media platforms and e-commerce sites. Since we offer an engineering-related product, we also partner with a lot of institutes in order to ensure that we're benefiting from R&D around the latest technologies."

*—2nd Gen Electric Power
Tools Supplier*

REVISITING THE 6CS

A STAX approach to enabling sustainable family businesses

Ultimately, we think there is a great deal that the nation's family business leaders can be proud of. Their vision, tenacity, performance and desire to perpetuate the family name are attributes that shine through in our survey findings and follow-up discussions.

However, as these businesses move forward to strengthen their approach to strategic thinking, succession planning, professionalization and innovation, leaders will encounter challenges when trying to rally key stakeholders. In particular, these challenges will be around achieving the fullest Conviction, Commitment and Contribution of these stakeholders.

When working with family businesses, STAX harnesses the 6C Framework to address these challenges by bolstering Clarity, Comfort and Capability.



CONVICTION THROUGH CLARITY



- What's the vision and purpose of the business?
- How are investments made in the business?
- How are decisions made in the business?
- What are the opportunities on the horizon?

COMMITMENT THROUGH COMFORT



- What is the company's distribution and remuneration policy?
- What are the succession plans of owners and managers?
- What are the prospects of business growth and profitability?

CONTRIBUTION THROUGH CAPABILITY



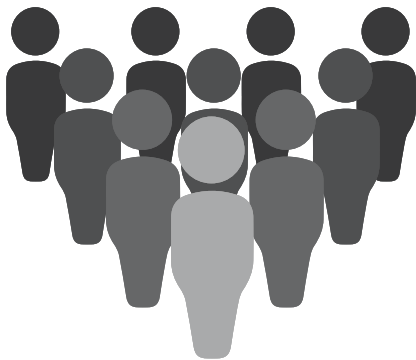
- What is the current level of competence across different levels in the company?
- Where does the business need to step up the prowess of its employees and its technological capability?

LOOKING AHEAD

From Japan's zaibatsu to the Tatas and Birlas of India, family businesses are some of the most enduring institutions in the world. At best, the bonds between kinsmen endue these businesses with the commitment, capital and corporate courage to thrive in tough market conditions.

Across the board, Sri Lankan family business leaders have revealed a passion for upholding the family name by delivering high quality products and services. Moreover, these individuals measure their success in terms of creating wealth and employment in society while providing a fair return to shareholders and other partners.

As these leaders look to the future, they are contemplating new avenues such as diversification, expansion beyond Sri Lankan shores and new financing options.

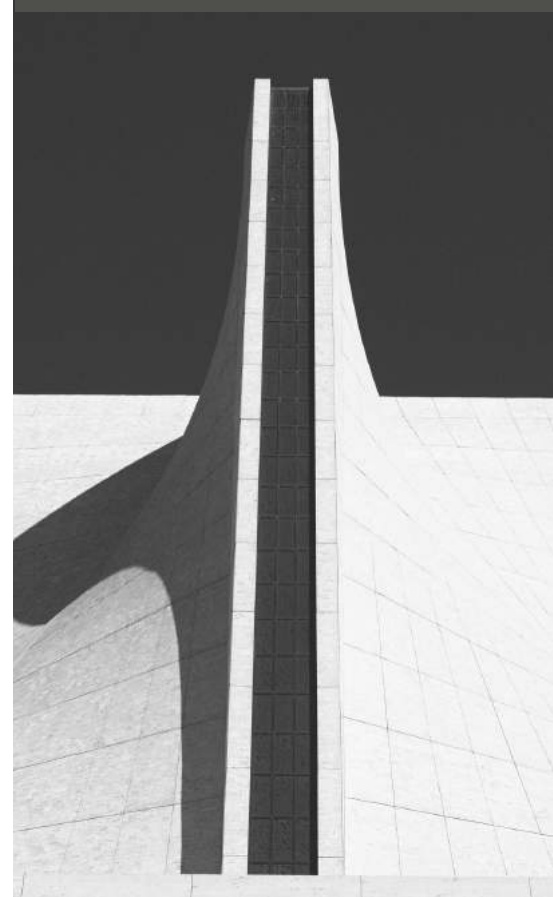


Given the variety of risk appetites amongst family members in the pursuit of cherished goals, some of the greatest challenges are likely to be around developing a strategic roadmap for the future while opening up the lines of communication and easing the stresses of generational transfer. Inevitably, as family businesses expand, they will also increasingly look for external management expertise; intensifying the war for talent.

The years ahead herald interesting opportunities for family businesses in Sri Lanka. As the challenges on the horizon also intensify, these firms will increasingly need the Conviction, Commitment and Contribution of both those in the family and beyond it.

**"SRI LANKAN FAMILY
BUSINESSES ARE IN
A TRANSITIONAL
MODE, SO
A NEW GENERATION
IS LOOKING AT NEW
IDEAS AND THEY
WANT
TO MAKE AN
IMPRINT."**

**-- DR. KUMUDU GUNASEKERA
DIRECTOR, STAX**



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CONTACT US

STAX, Sri Lanka's leading strategy consulting firm, has its headquarters in Boston, and branch offices across Chicago, New York, Colombo and Singapore. With a rich client base consisting of 15 of the top 20 global investors and 25+ Fortune 500 companies, Stax prides itself on being a full service consulting firm—from strategy to implementation. If you are looking for a nimble, collaborative, and highly focused firm dedicated to finding implementable solutions, we invite you to find out more.

strategy@stax.com

TAKING OVER THE MANTLE: SRI LANKAN FAMILY BUSINESSES TODAY