CEE Family Business Survey

Family businesses at a crossroads

40%
of CEE family businesses plan a change in ownership within 5 years

58%
of CEE family businesses are focused on making their operations more professional

73%
of CEE family businesses have sales from foreign markets

pwc

www.pwc.com/familybusinesssurvey

Methodology

Definitions

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.

Survey methodology

The CEE Family Business Survey was based on 162 online and telephone interviews with key decision marketer in family businesses in Russia, Poland, Romania, Slovakia, Hungary, Bulgaria, and Latvia. Data from different countries was weighted to reflect the relative a of those economies. Interviews were conducted between 17 June and 31 October 2014.

This survey was part of PwC's Global Family Business Survey which takes into account the responses of 2,378 family businesses in 40 countries worldwide. The turnover of participating companies was from USD$5m to USD$1bn. The interviews were conducted in the local language by native. The results were then analysed by Jigsaw Research

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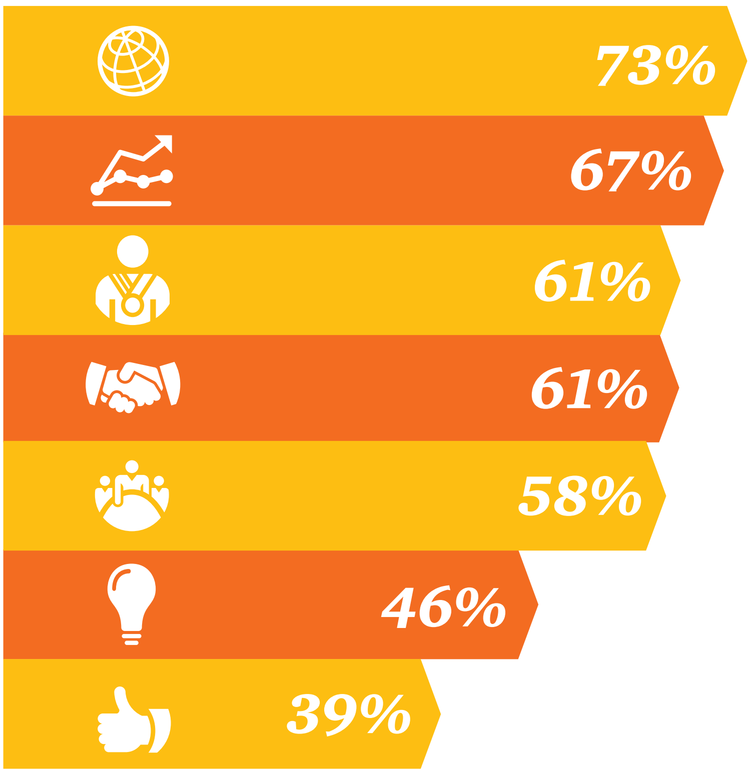
Executive summary and key findings

This is an exciting time for family businesses in Central and Eastern Europe (CEE). The fall of the Iron Curtain in 1989 marked the return to a market economy and the beginning of family business in this part of the world. A quarter century later, there are well-established family-owned companies, which are contributing positively to their local communities and economies.

Many CEE family-owned companies have now reached the level of maturity where they are ready to take their business to the next level to accelerate growth, improve profits and be more competitive. Many are looking to expand sales in international markets, transform their operations, and seize opportunities related to advances in technology.

Most family businesses in CEE are first generation. As many of their founders get closer to retirement age, they find themselves at crossroads and are facing critical decisions about the future of the business. Do we sell the business or pass it down to the next generation? Who will lead our business into the future?

This year's Family Business Survey gives a snapshot of the state of family businesses in CEE and sheds light on some of the key trends that are emerging as families look to take their business to the next level.



Going international
73% of CEE family businesses have sales from foreign markets

Growth
67% of CEE family businesses have grown in the last 12 months

Talent
61% of CEE family businesses see attracting the right talent as a key challenge over the next 5 years

Next generation
61% of CEE family businesses plan to pass on ownership of the business to the next generation, while 28% plan to sell

Professionalism
58% of CEE family businesses are focused on making their operations more professional (vs. 40% globally)

Innovation
46% of CEE family businesses see innovation as a key challenge over the next 5 years (vs. 64% globally)

Succession
39% of CEE family businesses have a succession plan in place for senior roles (vs. 53% globally)

The growth challenge

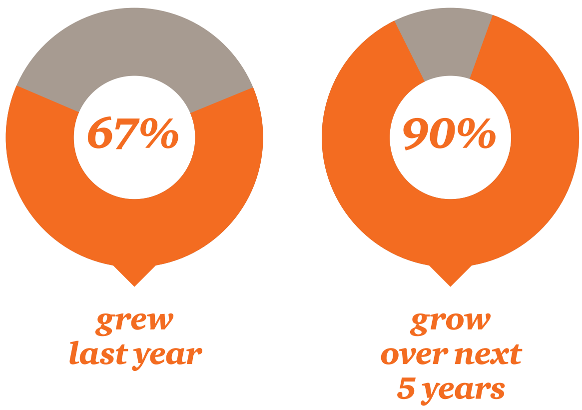
Growing despite the difficult markets

Businesses in Central and Eastern Europe have weathered tough economic conditions over the last several years. Many countries have experienced low or negative economic growth and currency volatility. This has been compounded by the recent political turmoil in Russia and Ukraine and the impact of the Euro crisis on the western part of the region.

These market conditions are worrisome to business owners. When asked to identify the biggest challenges over the next 5 years, 54% pointed to the general economic situation, 54% to political instability, and 51% to market instability.

However, despite the economic and political challenges, family businesses continue to perform well and are optimistic about the future. Within the last year, 67% of CEE respondents said they had achieved sales growth, which is just ahead of the global average of 65%. Looking forward to the next 5 years, 90% are looking to grow, and about a quarter of those plan to grow quickly and aggressively.

At the same time, the difficult economy is squeezing margins for many companies in CEE, and 30% of CEE family businesses said that maintaining or increasing profitability is a key challenge over the coming year. This was significantly higher than the global average of 11%.



Key challenges

What's keeping family business owners awake at night?

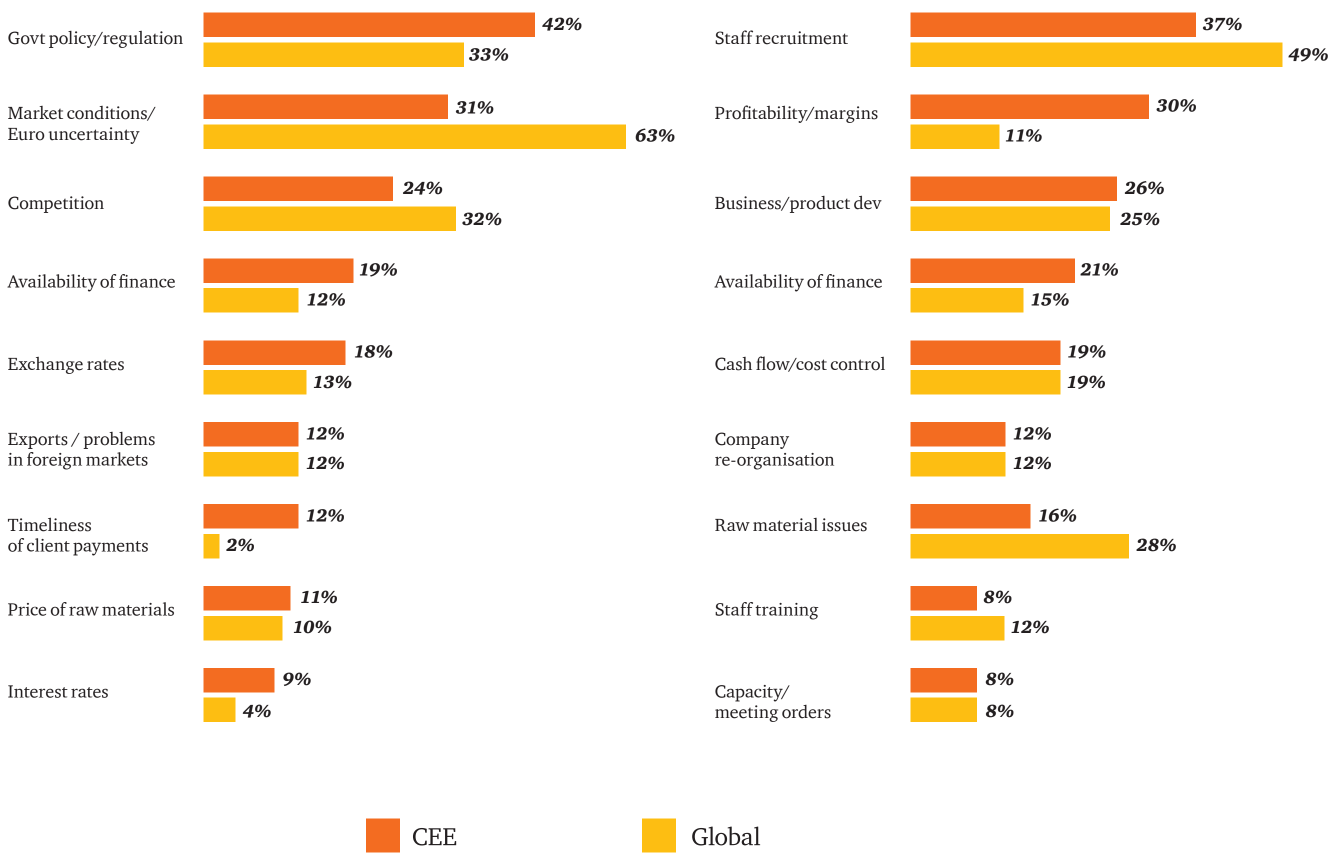
Given the political and economic turmoil in CEE, it is not surprising that issues such as government regulation and adverse market conditions top the list of short term external challenges. Economic and political issues are also key concerns over the next 5 years.

Given the difficult markets, it is not surprising that many CEE family businesses are trying to find a competitive edge. In the short term, this means prioritizing business and product development, while in the longer term many are looking to professionalise operations, innovate or invest in new technology. CEE family businesses are also concerned about competition, but to a lesser extent than their global colleagues, which could leave them vulnerable in an increasingly globalised economy.

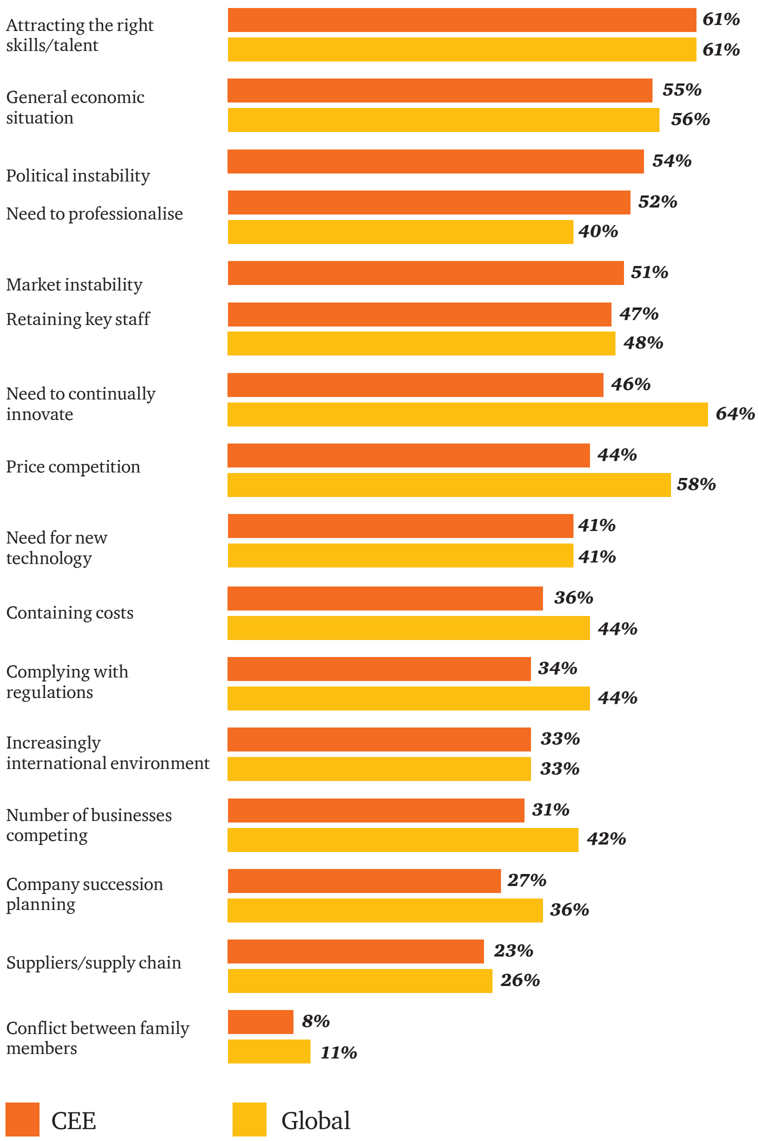
The ability to find the right talent will be the biggest challenge in CEE over the next 5 years, and is also one of the top concerns in the coming year.

Key external issues in next *12 months*

Key internal issues in next *12 months*



Key challenges in the next *5 years*



Doing the right thing

Family businesses are contributing to economies and communities across CEE

Many family businesses owners are guided by a strong moral compass, and two thirds of CEE respondents believed that family businesses have stronger cultures and values than other types of businesses. Most family businesses feel a close sense of connection and responsibility toward the economy, their people and the communities in which they live and work.

"The strongest legacy is a strong company that rewards people and community, that increases the living standards for its employees and their families, and that creates a business model in the industry."

Family Business, Romania, 2014

Economy

The vast majority of CEE family business owners believe that they make a positive contribution to the economy, by promoting economic stability (83%) and job creation (84%).

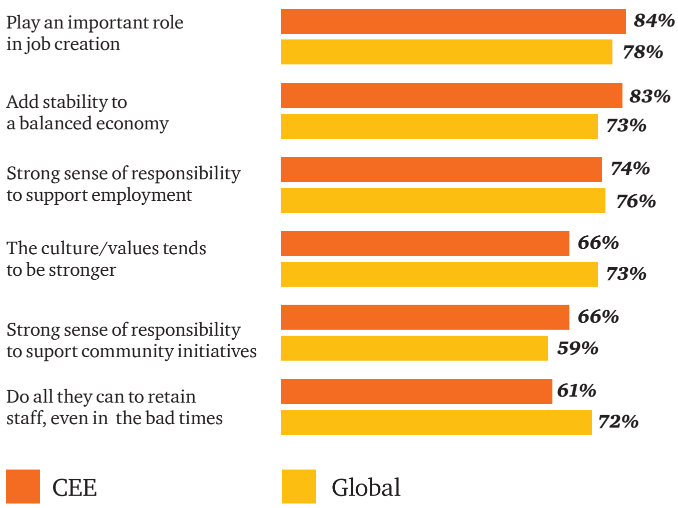
People

While 74% of CEE family businesses feel responsible for supporting employment, 61% said they will do all they can to retain staff through the bad times. This is slightly lower than the global average of 72% and likely reflects the difficult decisions that many CEE businesses have had to make due to the ongoing economic turmoil in the region.

Community

CEE family businesses also believe in social causes, and two thirds of them feel a strong sense of responsibility toward the community.

Do you agree that family businesses...



Funding growth

Access to financing continues to challenge CEE businesses

Finding a reliable source of financing can be a key challenge for family businesses in CEE. 44% of CEE respondents said that family businesses will have a harder time than public companies to benefit from the economic recovery due to issues with capital access. This is higher than the global average of 34%.

In the short term, while most family businesses are confident in their ability to fund operations over the next year, 21% of CEE businesses are concerned about access to financing (vs. 15% globally).

Internal financing and bank loans tend to be the primary sources of financing for CEE family businesses, but there are other viable sources of funding that family businesses might be underutilising.

Věra Výtvarová comments, "Taking into account the tighter credit conditions of banks and reasonable market interest rates, I see quite a lot of room for corporate bonds as an alternative source of financing for family businesses."

Private equity can also be a good option for some businesses as Alica Pavúková, Partner at PwC Slovakia explains:
"I believe that private equity or strategic partnerships are also an appropriate option to be considered by business owners when considering growth financing. If cooperation terms are set properly, then the common concern about loss of control will no longer be a barrier."

44% of CEE respondents believe family businesses will have a harder time to benefit from the economic recovery due to capital access (vs. 34% globally)

21% of CEE family businesses are concerned about access to financing over the next year

"You could hold an IPO, obtain lots of cash and use it for development. If you sell a share in the business, you could grow faster, but there are some downsides. First, you lose your 100% management. Second, rapid growth involves a lot of work and gives you no time for your personal life."

Ksenia Ryasova President of FiNN FLARE, Russia

Going international

Foreign markets offer exciting opportunities but bring a new set of challenges

73% of family businesses in Central and Eastern Europe currently sell to foreign markets and on average international sales account for 21% of revenue. CEE companies are looking to increase international sales to 29% by 2019, and they are looking to expand mainly within Europe.

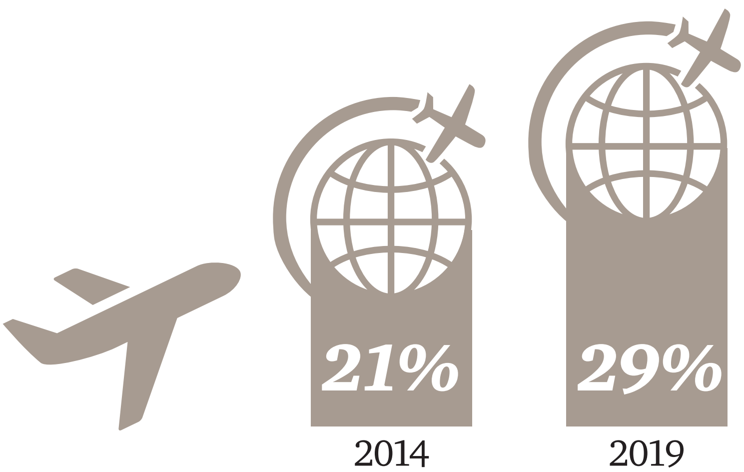
"Expanding internationally and building a presence in those regions we have chosen as our strongholds - particularly in the United States, the EU countries (starting with Germany), Turkey, and the Middle East and North Africa – are among our key objectives."

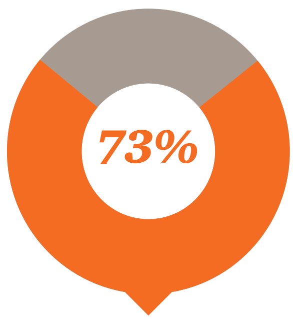
Vasily Ignatiev, General Director, R-Pharm

However, markets further afield offer significant opportunities, and family businesses can increase growth if they are willing to step out of their comfort zone. Piotr Wyszogrodzki, Partner at PwC Poland comments:

"Whereas CEE companies are very active in international markets, the majority tend to expand to markets that are close to home and similar in terms of culture and language. This is not surprising because it is easier and cheaper to do so, but achieving high growth will require reaching further. We have seen a number of pioneering family businesses from CEE reaching global markets and becoming market leaders. But this only happens when companies have the right mixture of innovative products, a talented team and well-done homework."

Albena Markova, Partner at PwC Bulgaria, adds: "There is a lot to consider when preparing to expand abroad. First you need to understand the market, assess opportunity and decide the best entrance strategy. You need to set up operations, hire the right talent, and find reliable business partners and suppliers. And of course you need to understand and comply with the foreign tax and regulatory environment. The list goes on. It certainly helps if you have an advisor on the ground who understands the local market and who can guide you through the hoops."





of CEE family businesses sell to foreign markets

Talent contest

Attracting and retaining the right talent

Access to the right talent is seen as a critical factor in achieving growth. However, finding and keeping people with the necessary skills is a major challenge for family businesses in Central and Eastern Europe. 61% highlighted the ability to attract talent and 47% mentioned retaining talent among their greatest challenges over the next 5 years.

However, given the difficult economic conditions in Central and Eastern Europe, businesses appear to be cautious about short term hiring - only 37% highlighted recruitment as a priority for the coming year, versus 49% globally.

61%

Attracting the right skills/talent is a key challenge over the next 5 years

47%

Retaining talent is a key challenge over the next 5 years

37%

Staff recruitment is a key issue over the next year

"I think that, for our company, the most important thing is mutual respect between the company and its employees."

Ksenia Ryasova, President, FiNN FLARE, Russia

"We rely heavily on the importance of the human factor, which along with technology are the main ingredients in the growth of our businesses. Human resources are the most powerful capital. Our people are experienced both locally and in the region, and we have the best people working in R&D, developing their own patents, formulas, products and systems."

Remus Aurel BENTA – CEO and Owner, DAW Benta Romania

Upping their game

Improving professionalism across the business

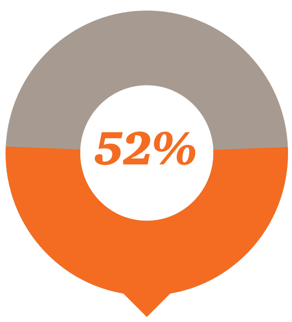
Family businesses are increasingly investing into making their operations more professional and corporate. Within CEE, 52% of respondents pointed out the need to "professionalise" as one of their key challenges. This was significantly higher than the global average of 40%, and indicates that family-owned businesses in this part of the world are approaching the level of maturity where they need to evolve their entrepreneurial culture to a more structured approach in order to take their business to the next level.

According to Alina Lavrentieva, Partner at PwC Russia, "There are three distinct areas where private and family firms feel the need to professionalise their operations: systems and processes, corporate governance, and people management. Clearly, these areas are closely interconnected. Only by professionalising their operations simultaneously across all three areas can businesses, both in CEE and globally, achieve better innovation, more effective diversification, and faster growth. In short, greater professionalism in these areas is essential for improved profitability and a sustainable, long-term future."

This trend is driven by a combination of factors, including positioning the business for accelerated growth or becoming more internationally competitive. The need to formalize processes can also be an essential step in preparing the business for the next generation, for sale or for a public offering.

"We want to be a modern business, and we are constantly on the lookout for new things appearing on the market that would help us optimise our work and improve efficiency. Many of our processes are already formalised and dealt with via various software applications, but as you professionalise you need to ensure you preserve your traditions and values as new people come in.“

Irina Eldarkhanova
Chairwoman, Board of Directors
of Confael, Russia



of CEE family businesses are looking to professionalise their business

The digital revolution

Disruptive technologies are changing the market landscape

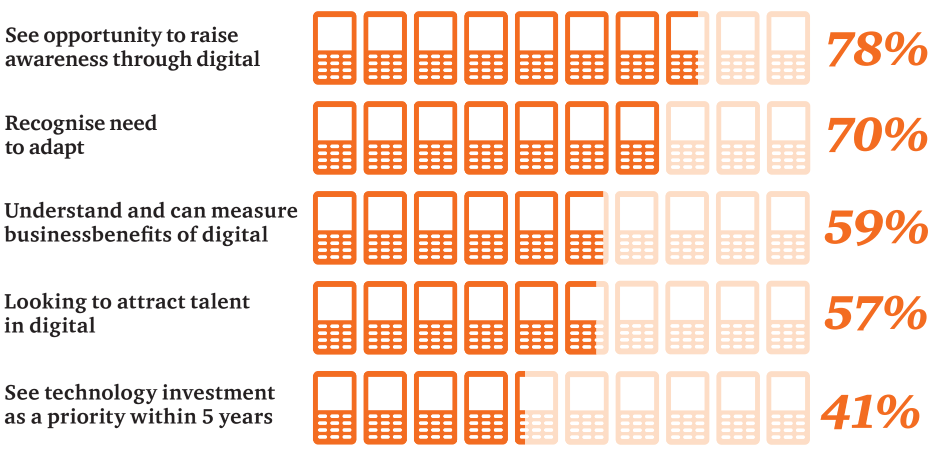
The pace of technological change is a major force in the market and 43% of CEE family businesses believe that technology will transform business over the next 5 years.

Věra Výtvarová, Partner at PwC Czech Republic, observes: "Digital technologies are a must in the 21st century. We found that 90% of companies entering new industries (different from their core business) were able to do so thanks to new technologies. But having digital technologies is only part of the puzzle. Businesses that really get it right incorporate digital technologies as an integral part of their company culture."

78% see an opportunity to raise awareness of their organization through digital channels. Vita Sakne, Senior Manager at PwC Latvia adds: "The continuous upgrading of technology and smart handling of large volumes of data are key challenges for companies in CEE. At the same time, businesses have an opportunity to use technology to create more flexible business models and get closer to their clients."

To make the most of this opportunity, and to keep up with the changing technological landscape, 70% recognize that their organization will need to adapt. Not all of them have started on this journey though. 59% understand the tangible business benefits of moving to digital and have a realistic plan for measuring them and 57% are looking to attract talent to undertake the conversion to digital. 41% see the need to invest in new technology for the business as a priority in the next 5 years.

CEE family businesses on technology



Innovation

Are CEE family businesses missing an opportunity?

The ability to innovate is one area where family businesses have a potential strategic advantage over other organisations. For example, 64% of CEE businesses believe they are more open to taking risks and 70% believe they are more agile in decision making than public company. Furthermore, 68% believe that family businesses have the power to reinvent themselves with each generation. If harnessed correctly, these factors can contribute to a culture that fosters ongoing innovation and development.

As Věra Výtvarová, Partner at PwC Czech Republic explains: "Innovation is part of the DNA of all family businesses; it is the only way to survive. The innovation process in the vast majority of family businesses is less structured and formalized, compared to multinationals."

However, CEE family businesses are less focused on innovation than their global colleagues. 46% of family businesses in CEE are focused on the need to innovate as a key challenge, compared to 64% globally. As business becomes increasingly international, CEE companies could face greater threats from more innovative foreign competitors entering their markets.

Innovation as a key challenge over the next 5 years

Family matters

Succession planning is critical in achieving a smooth transition of ownership and management

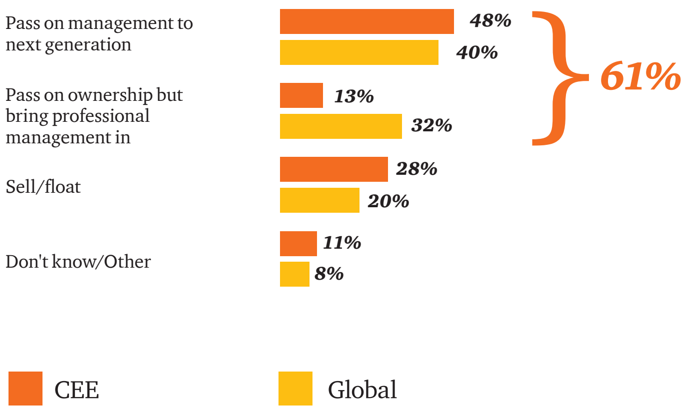
The profile of family businesses in CEE is unique compared to the rest of the world. Since entrepreneurship was only possible after the fall of communism in 1989, 77% of respondents are first generation businesses, compared to 30% globally. In most of these first generation businesses, the original founder is still very much at the helm of the business.

Many of these pioneering entrepreneurs are now approaching retirement age and need to decide what's next for their business. 40% of CEE respondents anticipate a change in ownership within the next 5 years.

Alexandru Medelean, Partner at PwC Romania comments: "CEE family businesses are now in one of the most important stages in their development since 1989 - the first transfer of ownership. This phase will mean either keeping the business in the family, selling it, or unfortunately in some cases, the demise of the business. In any case, the decision will have a direct impact on the owner's wallet."

Overall, 61% of CEE family businesses plan to pass down ownership to the next generation, while 28% plan to sell or float the business. Of those who plan a change within the next 5 years, 55% plan to keep the business in the family, while 38% plan to sell.

Future plans for the ownership of the business

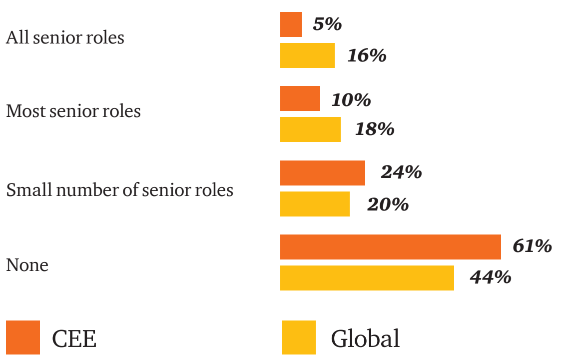


"Succession should be professional and not according to inheritance. I don't think it's right to pass a business on as some sort of right of kinship. It should be done strictly in accordance with professional considerations."

Vladimir Slobodyan,
Co-Owner and General Director, Institute for Ecological Design and Research, Russia

So it is rather surprising that most CEE family businesses do not have a formal succession plan in place and many do not even have a clear successor. Only 27% of CEE respondents mentioned succession planning as a key challenge over the next 5 years, which is lower than the global average of 36%. Only 39% of CEE family businesses have a succession plan for at least some roles compared to 53% of global, and only 4% have a succession plan that is robust and documented.

Succession plans for senior roles?



Piotr Wyszogrodzki, Partner at PwC Poland, offers an explanation of this trend. "I believe it's tougher for the business founder to pass the business on than it is for subsequent generations. However, you need to keep in mind that family businesses usually fail for family reasons. Therefore professionalising the firm and planning proper succession processes will enable smooth transition and make it easier for the successors."

"Family members must start at the bottom. You cannot simply join and become a director. You have to go through the whole route."

Ksenia Ryasova President of FiNN FLARE, Russia

The next generation

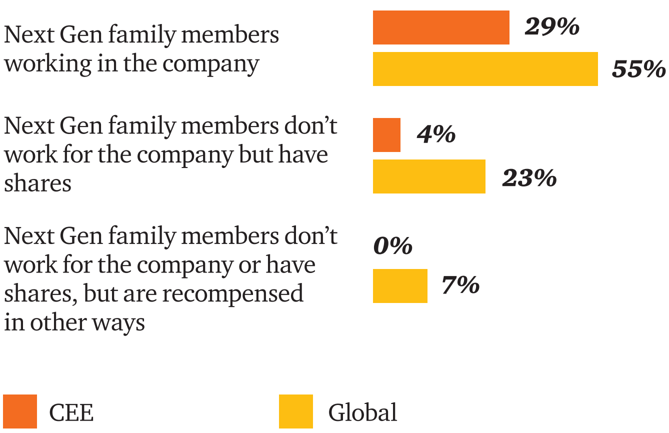
48% of CEE family businesses want to pass both ownership and management to the next generation, while only 13% plan to pass down ownership but bring in professional management from outside. Globally, owners are much more likely to bring in outside help: 32% plan to bring in professional managers to support next generation owners.

To effectively pass along management of the business, next generation leaders need training and experience before taking over the helm. However, only 29% of CEE family businesses currently have next generation family members working for the business, compared with 55% globally.

"Formal education, skills development and professional management play a very important role in the success of a family business. It is absolutely necessary to hire external professional management when the family does not have the expertise to manage certain aspects of the business."

Andrei Ioan OLTEAN – Development Director, MAVIPROD Group

Next Gen family involvement in the business



Succession planning

An effective succession plan will ensure a smooth transition of ownership and management and will help prevent any loss of value when the owner steps down. At the same time, it will provide clarity to the next generation - allowing them to prepare for the change, while helping to maintain family harmony.

The succession process should start as early as possible and should be linked to the overall business strategy. Owners need to look at the current and future leadership roles within the business and identify potential successors. They then need to work with the successors (and other managers and family members) to agree the way forward. Succession plans should be formalized and properly documented (eg. ownership structure, accountability, processes, conflict resolution) to provide clarity and avoid disputes.

The next generation leaders also have an important part to play. They need to invest time into understanding the business and industry and forming relationships with customers, staff and other key stakeholders.

Hoping for the best, planning for the worst

Effective safeguards can prevent family conflict and ensure business continuity

In family businesses, business is personal. While the company can be a source of pride that brings the family closer together, it can also be a source of tension. An unresolved conflict about the management or ownership of the business can have terrible consequences on family relationships. At the same time, family issues – such as a death, divorce, illness or accident – can throw the business into disarray. Having clear processes in place can prevent disagreements about the business from escalating into family crises, and vice versa.

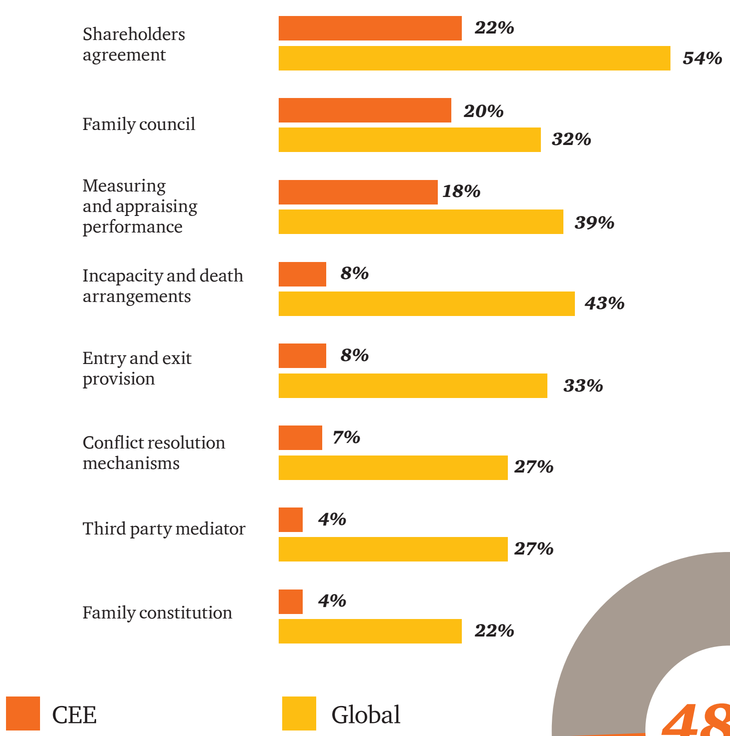
However, only 52% of CEE family businesses have a procedure or mechanism in place to deal with conflict. This is much lower than the overall global average of 83%, and in general, business owners in other parts of the world apply all of these mechanisms more frequently than in CEE.

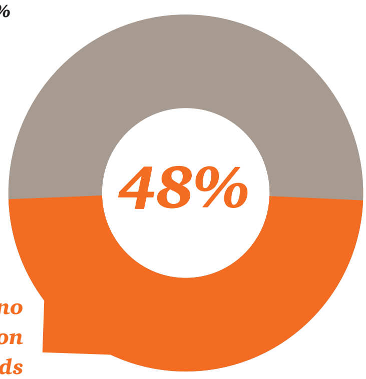
The most common safeguards include shareholders' agreements, family councils, and performance management systems, but even these are used only in a minority of CEE businesses.

"In general, a family business is quite challenging. When interests collide, a conflict is born. But, of course, all of this can be settled through negotiation; we simply make concessions to each other."

Irina Eldarkhanova, Owner and Chairwoman, Board of Directors, Confael, Russia

Procedures in place





of CEE family businesses have no formal conflict resolution safeguards

Selling the business

Maximising value for the family

In cases where there is no family successor willing or able to take over the family business, many owners are taking the decision to sell or float the business. There are also other motivations that can influence a family's decision to sell, such as personal ambitions, economic conditions, shifting consumer demand or industry consolidation.

Alina Lavrentieva, Partner at PwC Russia commented: "There's no doubt that the overall economic picture and uncertainty about the future are influencing plans in favour of business disposal as a long-term option. There is also a growing generation gap caused by the fact that people are having children later in life, which can lead to significant misunderstanding and failure to communicate between those who are currently running a business and those who are expecting (or are expected) to inherit it."

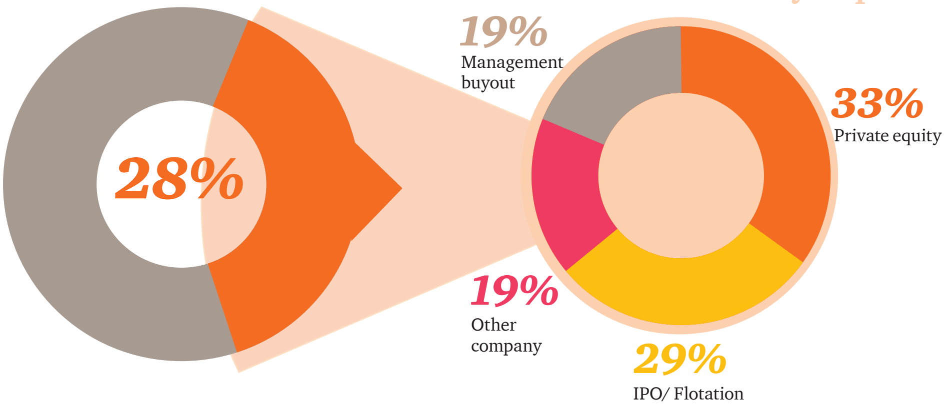
When families make the decision to sell, there are steps they can take to ensure they get the best selling price for the business.

According to Miklos Fekete, Partner at PwC Hungary, the first step is to put in place robust financial controls: "Before selling a business, I always recommend to owners that they spend the time and money to implement the relevant financial controls and reporting. It will increase shareholder value significantly - far outweighing the costs. This includes having an independent external audit, robust management reporting, and business planning addressing KPIs. The fact that you believe your business is well run is not enough when you try to sell it. Buyers demand evidence and certainty, and without proper historical and current financial information this is difficult to prove. I've seen transactions fail and companies sold at a discount because of this."

According to Alex Srank, Partner at PwC Slovakia, owners should also consider seeking an impartial valuation of the business. "If an owner wants to hand over or sell his business, he should know its value. There are several methods of assessing the value of a business – from the present value through the expected value of future cash flows, to the results of a valuation or transaction of a business of a similar type or size. Consulting on the valuation with a reliable third party is a reasonable option, as the owner's emotional links to the firm often prevent him from an objective evaluation of the business and may, therefore, directly affect the attractiveness and value of the business for potential buyers."

28% of CEE family business plan to sell or float their business

To whom do you plan to sell?



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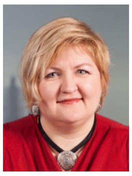

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