CHINA'S SECOND GENERATION

Will the 'Fuerdai' Continue to Run the Family Business?

Family-run businesses in China constitute an incredibly important part of the national economy. Private enterprises accounted for about 86 percent of the Chinese market in 2015,[1] with most of these firms being classified as family-run businesses, this group dominates the country's corporate landscape, playing a huge role in employment, job creation and the generation of gross domestic product.

Economic liberalisation in the late-1970s provided the catalyst for China's entrepreneurs to grasp new opportunities. Many leveraged this era of market reforms and rapid growth in the Chinese market to start-up and grow their own businesses. However, as China's first-generation of entrepreneurs now hit their 50s and 60s and look to retire, questions around leadership transition and succession have raised many new challenges.

Succession planning for Chinese family businesses has always been a contentious matter. Having worked incredibly hard to build their own business, first-generation entrepreneurs in China express an overwhelming desire to maintain control within the family — even as concerns on whether their successors have the willingness and experience to manage the business begin to dominate the conversation. This reluctance to hand over management to outside professional managers saw a high-profile turn after Wang Jianlin, founder and chairman of Dalian Wanda Group (and currently China's wealthiest individual), declared his intentions to pass over the reins of his business empire to an external professional manager. Dalian Wanda Group is China's most prominent real estate developer as well as the world's largest movie theatre operator.

In a recent address to his company, Wang was quoted saying: "I have asked my son about the succession plan, and he said he does not want to live a life like mine," He then went on to say: "Perhaps young people have their own quests and priorities. Probably it will be better to hand over to professional managers and have us sit on the board and see them run the company."[2]

While this statement from Wang is quite out of the ordinary and does not conform to the traditionalists' Chinese view that the family business shall remain within the family, it could be a sign of things to come as we expect to see many more Chinese families breaking tradition and relinquishing control of their businesses to let outsiders or professional management firms run their company.

Over the next 10 years, a number of self-made Chinese billionaires such as Wang are expected to address questions around succession. Family-run businesses across China will be entering into a new phase marked with a number of leadership transitions from founders to their children. As a result, succession planning (or lack thereof) has visibly become a concern.

1 State Administration for Industry & Commerce (SAIC), http://www.scmp.com/business/companies/article/1982179/accurately-pricing-family-business-succession-plan

2 http://www.scmp.com/news/china/money-wealth/article/2053915/chinas-wealthiest-man-considers-picking-successor-his-only

While times of leadership transition always bring about uncertainty, this is much more pronounced in family businesses where the changeover can result in the loss of personal business connections and insider knowledge. In line with this, the track record for generational transitions has not been very favourable with one study (conducted by Professor Joseph Fan of the Chinese University of Hong Kong) showing that companies lose nearly 60 percent of their value during the transition from one generation to another.[3]

The challenges of succession planning tend to be more acute in Asia where cultural sensitivities around the matter of retirement make it difficult to then broach the subject of transition. As a result, many families do not spend time carefully planning the transfer of management from one generation to another and consequently expose their businesses to more risk.

Traditional Barriers

Traditionally, the Chinese family philosophy is to divide ownership of its business equally amongst its family members when the founder moves on or retires. Unwritten rules pertaining to governance and control of the family business are based on intimate histories, complex cultures and family values. Very often nothing is formally documented.

When a business is primarily under sole ownership and then divided and transferred to several owners, the likelihood of conflict is high. The goals and interests of one family member may not align with the others, making it very difficult for family members to work in harmony for the family name, particularly when interfamily clashes take place or if certain family members take advantage of the situation in order to reap more benefits than others. The scenario often results in disputes amongst family members that end up spilling into complex, drawn out and expensive legal proceedings. One does not need to look any further than the highly-publicised Yung Kee feud which unfolded in Hong Kong.

The founder of the Yung Kee business created his wealth and empire by selling BBQ goose. When he passed away, he amassed a fortune valued in excess of HK$1 billion.

The founder had perceived that Yung Kee would be managed by his two eldest sons. Accordingly, both sons received an equal share of 35 percent each in the business. The remainder of the Yung Kee business was equally divided amongst the founder's wife, daughter and his third son, each receiving a 10 percent share. In unfortunate circumstances, the third son died and passed his 10 percent share to the second eldest son. A few years later, the founder's wife transferred her 10 percent share to the eldest son, making both sons equal owners of the business. The genesis of the family dispute took place when the daughter decided to transfer her 10 percent share to the second son, thus making him the majority owner of the Yung Kee business. The second brother allegedly then shunned the elder brother from managing the business in any way which resulted in the elder brother launching legal action against his younger brother in order to either buy his shares out or wind-up the entire business.

One may argue that it was traditional thinking of equally dividing shares that then became the catalyst for the ensuing family feud. In the past, disputes were settled internally within the family and this was successful because the sole founder was always the dominant decision maker. As soon as you have multiple stakeholders in the fold, the rules of engagement must be clearly documented. Otherwise the room for disputes remains large and the chance of business value being destroyed is greater. This can be a foreign concept for Chinese families thoroughly embedded in their traditions who strongly feel that this is "not how we do things." Accordingly, professional advisors are often called in too late, and are left to clean up the mess or manage the crisis, as opposed to assisting the family in preparing for the inevitable.

Reluctant Leaders

China's wave of successful entrepreneurs has created a unique phenomenon in the country: the second-generation rich, commonly known as "fuerdai." Known for their exorbitant spending, expensive cars, brand name clothing and swanky gadgets, the fuerdai are also perceived by society to only know how to show-off their wealth, and lack the ability to create wealth like their parents.

Like Wang's son, the children of first-generation entrepreneurs often show a lack of interest in taking over the family business.

A recent survey of 182 Chinese family companies, conducted by the Shanghai Jiao Tong University, found that 82 percent of surveyed heirs said they were reluctant to take over the family business. Aside from not wanting to live like their parents as Wang's son had purported to him, a majority of the founders' children who were tertiary educated overseas have shown more interest in pursuing other careers and interests. Globalisation of the modern world has provided some of these Chinese children exposure to more diverse cultures and ways of thinking. As a result, a considerable proportion of the fuerdai, at least two out of every ten, chose to start their own businesses, mostly in different areas to 'prove themselves.'[4]

Those who remain in the family business will also face challenges. Research has shown that only 30 percent of all family businesses survive in the second generation. Most family businesses fail due to a lack of trust or misalignment in terms of goals and objectives from generation to generation, or even amongst family members in the same generation. What is more, replicating or displaying the same leadership style, charisma and loyalty as the founder of the business is often a challenge for second-generation owners. This means that family businesses lose vital assets that had made the company so successful in the first place.

3 https://www.ft.com/content/33aac6fa-c16f-11e2-b93b-00144feab7de

4 http://blogs.ft.com/beyond-brics/2014/02/27/guest-post-chinas-family-businesses-have-a-succession-problem/

Keeping it Outside the Family

Wang's comment about hiring professional managers to run the family business strays from most first-generation entrepreneurs. Advisors to families tend to be trusted friends of the family and often they are not specialists in say, communications, dealing with contentious matters or professional turnaround and restructuring officers. Outsiders running the family business are not often viewed positively given that they are regarded as not being aligned with the family ideology. However, families can avoid the trouble of dealing with conflict by engaging professional advisors whose job is to ensure that there is a solution to meet everyone's needs. Certain family businesses in the U.S. and other western jurisdictions like 21st Century Fox and A.O. Smith have thrived by letting outsiders run certain parts of their business to ensure longevity. Founders who wish to maintain harmony amongst the heirs and preserve the value of the business should engage professional help in order to collectively engage the next generation in the succession planning process. Professional advisors do not bring the emotional element to the table and can advise family members on their various options.

There are many factors that can make or break a succession plan:

- **Focusing on communications.** When the business is undergoing a transitional period, it is important that the right message is conveyed to employees and customers/suppliers to ensure that everyone is kept up-to-date on key information and important changes.
- **Establishing goals and governance.** It is vital going forward that rules are documented and agreed on. Communicating these updates to family members is crucial to prevent the chance of disputes.
- **Being prepared.** Discuss the transition and succession plan in detail so that the role of each family member is outlined and timelines are shared with the relevant parties. Establishing all available options for the business is also critical as running on an 'as is' basis may not be the best choice when compared to a sale and purchase agreement, buyout or the engagement of outside professional managers.

It is essential to keep in mind that the lack of a succession plan will only cause unwarranted disputes. Our firm handles and advises on contentious matters involving Chinese families. Disputes amongst family members are emotionally stressful and often cause the owners to lose focus of managing the core business. Often professional advisors in this region are called in too late and what we often see is a rapid deterioration of value in the business.

There is no benefit in having a disinterested heir or someone who is lacking the right experience to continue the trade of the business. To ensure stability and success, we believe it is critical that the successor is chosen early and that it is communicated properly to relevant family members and employees. If there is no one suitable for the role, consider outside parties to take the reign. Going forward, it would appear that professional advisors will play a vital role to family businesses, providing owners with an objective view and applying their tools of trade to ensure a smooth and successful transition.

Ken Fung
Senior Managing Director
+852 3768 4617
kenneth.fung@fticonsulting.com

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