5-2016

Inter-generational Transitions of Family Businesses using Private Equity: Lessons for China and Australia from Chinese Family-owned Enterprises in Singapore

Pi Shen SEET
Flinders University

Christopher GRAVES
University of Adelaide

Wee Liang TAN
Singapore Management University, wltan@smu.edu.sg

Published in China's changing economy: Trends, impacts and the future, 2016, Pages 110-135.
ISBN: 9781138945975

Inter-generational transitions of family businesses using private equity

Lessons for China and Australia from Chinese family-owned enterprises in Singapore

Pi-Shen Seet, Christopher Graves and Wee-Liang Tan

Introduction

Chinese family businesses have played a major role in the development of Singapore's economy since the early nineteenth century. Some of them have grown to be large, established businesses that form a significant part of the Stock Exchanges of Singapore and Kuala Lumpur (Lee and Chan, 1998). With the prominence given by media, society and the establishment to the large, successful, multi-generational Chinese family businesses in both countries (Pan, 1990), the bulk of the research in this area has also focused on these large firms. For example, some research has been conducted on intergenerational transitions of large Chinese family businesses in Singapore (Tan and Fock, 2001). However, the majority of family businesses in Singapore, and the rest of the world, are small or medium-sized, and an estimated 80 per cent of all small-to-medium-sized enterprises (SMEs) in Singapore are Chinese family businesses (Carey *et al.*, 2005).

In addition, most existing research has focused largely on the success factors behind Chinese family businesses in various parts of the world, with studies alluding to the network effects, immigrant culture and business savvy characteristics to explain their success (Gambe, 2000; Lee and Loh, 1998; Menkhoff and Gerke, 2002; Saxenian, 1999; Zapalska and Edwards, 2001). However, there is little research focusing on how they secure resources and financing in the context of inter-generational change.

This chapter aims to address some of these research gaps by looking at family-owned SMEs (SMFEs). In particular, it examines the considerations of Chinese SMFES in Singapore when they engage with the private equity (PE) sector as part of the overall capital-raising and harvest strategy. This is relevant as there is a crisis in family business succession, with the majority of Asian SMFE owners unable to hand over their business to the next generation and many hoping to sell out in the near future (Yeung, 2000). Following recent trends of PE involvement in family businesses in Europe and North America, which have more rapidly ageing populations (Maherault, 2004; Reier, 2006), the rapid growth of Asian PE since the 1997 Asian Financial Crisis (Lockett and Wright, 2002) has led to options to restructure business ownership using PE firms (e.g. via management buy-outs (MBOs), management buy-ins (MBIs) or buy-in management buy-outs (BIMBOs) (BVCA, 1999). However, most SMFE owners are unprepared or ill-equipped to engage with such organizations.

Building on previous work by Poutziouris *et al.* (2000), this chapter presents findings from research based on in-depth interviews with five Chinese SMFE owners in Singapore as to what fears and issues are preventing these family business owners from currently seeking such funding. In doing so, the study finds knowledge and perception gaps among Chinese SMFE owners in Singapore vis-à-vis the PE community and proposes several measures for how financial and economic development agencies, as well as trade and professional services associations, can help bridge the gaps. Overcoming these gaps can assist in helping Asian economies achieve a smooth transition for SMFEs and build on the value that they have created in the past.

The chapter is structured as follows. We begin by outlining the context of Chinese SMFEs and PE in Singapore. We explore issues surrounding empathy and knowledge gaps between family firms and PE to develop a model of barriers to the use of PE in family firms which forms the foundation for this study. This is followed by an examination of the model through a qualitative study of Chinese SMFEs in Singapore. The chapter argues that there are similar trends among family businesses in China as well as Australia, with their rapidly ageing populations creating succession difficulties, and concludes that there are significant opportunities for PE investment in both countries, particularly in China, given the rapid development of the PE sector in China.

The context

Family business and SMFEs in Singapore

SMEs form 99 per cent of all firms in the Singapore economy and employ 70 per cent of workers, as well as contribute to over 50 per cent of national GDP (Department of Statistics Singapore, 2013). Family businesses form the bulk of these SMEs, and while on average they employ between 10 and 100 people and have an average turnover of less than S$10 million, as a group they make up 80–90 per cent of industrial companies, thereby forming a significant component of the Singapore economy (Lee, 2006). In spite of this, most of the research in the Singapore family business sector has focused on larger firms and not on SMEs (Lee and Chan, 1998; Tan and Fock, 2001).

Chinese family businesses in Singapore

Among the SMEs in Singapore, it is estimated that 80 per cent of all SMEs in Singapore are founded and operated by the ethnic Chinese community as family businesses (Carey *et al.*, 2005). These ethnic Chinese form part of the overseas Chinese diaspora that have become a fascination for many researchers and policy makers in the past century or so, with studies alluding to the network effects, immigrant culture and business-savvy characteristics to explain the success of overseas Chinese firms (Gambe, 2000; Lee and Loh, 1998; Menkhoff and Gerke, 2002; Saxenian, 1999; Zapalska and Edwards, 2001). They differ from mainland Chinese entrepreneurs as they are born and bred and have worked in overseas Chinese communities for generations. They may have been descendants of the Chinese diasporas over the last few hundred years, with most leaving China during the Opium Wars, World Wars and Civil War between the Communists and the Kuo Min Tang (Pan, 1990).

While many of the Chinese SMFEs in Singapore have thrived in the last few decades and many have grown to be large firms (Lee and Loh, 1998), they face a unique set of challenges in the coming years. Among the issues is that with the decline in birth rates among the Singapore Chinese population, which was accelerated by a highly effective population planning policy in the 1970s and 1980s following the baby boom (Cheng, 1989), there have been fewer members of the next generation to succeed the Singapore Chinese SMFE owners when they retire. Research by the Economist Intelligence Unit and Citibank in Singapore has shown that 40 per cent of these SMFEs have given up on finding a suitable family successor and are prepared to handover to professional managers, with only 22 per cent of them confident of passing on the business to the next generation and 17 per cent wishing to sell out altogether (Economist Intelligence Unit and Citibank, 2006). This is in line with the trend of the majority of Asian SMFE owners unable to hand over their business to the next generation and many hoping to sell out in the near future (Yeung, 2000). The problem seems to have grown in recent years, with one-third of family businesses in Singapore now considering selling out altogether (KPMG, 2012). As the recent KPMG study comments:

> Our view is that business owners usually want to pass the business to their own family member. They will not plan to employ someone from outside the family unless they have no option.... The younger generation sometimes do not want to take over the business as they have other career plans.
>
> (KPMG, 2012)

PE in Singapore

In the last 20 years or so, in order to move up the value chain and develop innovative firms, the government of Singapore has had a policy of promoting the development of the PE industry in general and early-stage venture capital in particular, in an attempt to imitate the Silicon Valley model (Koh and Koh, 2002). In line with this, research into venture capital in Singapore has been subject to quite a large number of studies (Bruton *et al.*, 2002; Hindle and Lee, 2002; Ray, 1991; Wang and Sim, 2001; Zutshi *et al.*, 1999). To that end, it is now acknowledged that the venture capital market in Singapore is 'well-established' (Wright *et al.*, 2005).

The studies point to four main trends that have a significant impact on SMFEs. First, the government has a significantly high participation rate in the venture capital industry. In 2000, government-originated funding provided for at least 19 per cent of the US$7.4 billion invested (Guide to Venture Capital in Asia, 2001). Second, while the aim of the government is to support the development of innovative local firms, the bulk of the investments in the Singapore venture capital industry is not invested in local firms, with more than 85 per cent of funds invested overseas, mainly in the surrounding region, as there are insufficient opportunities in Singapore (Bruton *et al.*, 2002). Third, 40 per cent of funds are invested in the early-stage firms, largely due to venture firms needing to meet the criteria for preferential tax treatment for investment gains (Koh and Koh, 2002). This is significantly higher than in other Asian countries (e.g. 25 per cent in Taiwan (*European Venture Capital Journal*, 1999)), and reflects the government's attempts to support the early-stage technology firms. However, fourth, of the funds that are invested in Singapore firms, about 60 per cent are in 'low-technology' firms (Zutshi *et al.*, 1999).

The net result of these trends for SMFEs in Singapore is that unless the firm is an early-stage firm operating in a sector considered 'strategic' by the Singapore government, it is less likely that the venture firms would consider investing in them. While Asian, venture capital and PE have historically focused more on late-stage expansion financing and investment in mature companies, rather than early-stage financing in start-ups (Chu and Hisrich, 2001), the government incentives have shifted the focus to early-stage firms. The lack of interest in later-stage PE investments is also reflected in that there are almost no research studies on private-equity funded management buy-outs in Singapore.

Literature review

PE and family firms

PE investment, especially through buy-outs, has been found to be attractive in the private family firm sector (Wright and Burrows, 2008). It has been found to offer an alternative exit route for family firms that have not been able to find appropriate successors to assume ownership and/or management responsibilities (Bachkaniwala *et al.*, 2001; EVCA, 2005; Wright *et al.*, 1992). Even if there are potential successors, families may not have the entrepreneurial commitment or the requisite resources and capabilities for continued growth and survival in an increasingly competitive and dynamic global marketplace. However, there may be professional managers who possess sufficient interest and knowledge to take on the challenge of making innovative and entrepreneurial changes and thereby ensuring business growth and survival (Howorth *et al.*, 2004). Although a trade sale or an initial public offering (IPO) may be alternative options, these may be unattractive as the family may no longer be involved in the business (Scholes *et al.*, 2008) or it may require technical and financial resources beyond the capabilities of the family (Poutziouris, 2002). In such cases, an MBO may be appropriate as it

> may be a means of effecting succession and be acceptable to the founder as the best way to preserve their psychic income (non-monetary satisfaction) through maintaining the company's independent identity and culture, as well as continuing to be involved in the business.
>
> (Wright, 2007: 296)

If internal professional managers do not possess sufficient interest or skills to be owner-managers, but external parties can identify potential opportunities in the family business, then an MBI may be more appropriate (Robbie and Wright, 1996).

A survey of family firms involved in PE-backed buy-out deals in Europe by the EVCA found that 33 per cent would have ceased to exist had it not been for a buy-out/buy-in involving PE (EVCA, 2001). In Europe, PE-backed deals involving family firms have been increasing as a proportion to other deals (Figure 8.1) so that in the decade leading up to 2007, the combined value of European buy-outs/buy-ins involving family firms rose from €11.2 billion to €18.3 billion and a majority of them (62 per cent) were PE-backed (Wright *et al.*, 2008).

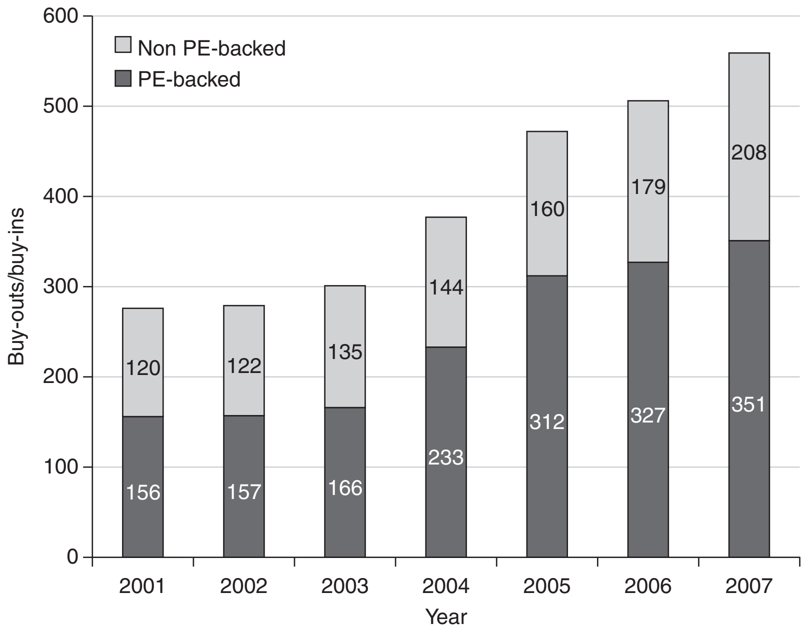

Figure 8.1 Number of PE and non-PE-backed buy-outs/buy-ins of family firms (€ million) (source: Wright *et al.* 2008).

While there is currently little evidence of active engagement by SMFEs with PE, there has been, in general, little research into how SMFEs and/or their advisers engage with the PE sector (Romano *et al.*, 2001), let alone in the Asian and particularly Chinese family business context. In some studies, a dislike for institutional finance, particularly external PE, has been identified (Gallo and Vilaseca, 1996; Upton and Petty, 2000). This 'empathy gap' may be due to asymmetries between family business sources of capital and their personal, business and familial objectives (Gasson, 1999). Poutziouris *et al.* (2000), in exploratory work, show that some family businesses are open to external capital for long-term investment to develop new technologies and markets. However, this may not be significant as the evidence indicates that when there is PE involvement, most of the deals are on restructuring ownership (e.g. MBOs) instead of facilitating entrepreneurs to grow new ventures (Joseph, 1999).

Moreover, Poutziouris (2001: 289) remarks that the 'empathy gap' may not be as significant as a knowledge gap as 'family companies (may be) antithetic to venture capital options simply because they feel less knowledgeable and comfortable about deal structures' in particular and the PE industry in general. Harvey and Evans (1995: 164) agree, noting that:

> The cost of capital from venture capital firms normally goes well beyond the financial parameters of the loan arrangement. They frequently expect … a host of other requirements. Many of these requests would seem foreign in the privacy of the family business.

Poutziouris (2001) also notes that his comments above, which reflect the state of existing research, are based on anecdotal evidence and calls for more rigorous examination of the relationships between PE and family businesses, which this study aims to partly address.

One way to close the empathy or knowledge gap between business owners and PE may be through the use of professional advisers, because when the SMFE grows, such advisers are engaged to advise the owners on the increasing complexities of business transactions as part of the professionalization process (Gersick, 1997; Gurd and Thomas, 2006; Hofer and Charan, 1984). This is shown in the model in Figure 8.2. However, there is little research or evidence that the professional adviser may have experience in PE deals or appropriate knowledge of the sector and therefore the capability to help bridge any empathy or knowledge gaps that the business owners have.

Methodology: multiple-case study design, in-depth interviews and content analysis

The research is exploratory in nature, and given the lack of in-depth literature and empirical studies conducted in the past, a multiple-case study design was adopted (Holstein and Gubrium, 1997). As it was important in this exploratory research to gather 'rich' data (Steyaert and Bouwen, 1997), the data were

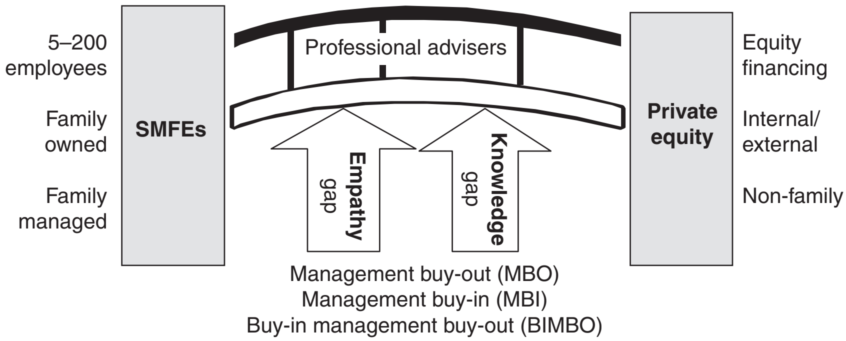

Figure 8.2 Model 'barriers to using PE in family firms'.

collected primarily via in-depth guided interviews with five Chinese SMFE owners in Singapore as there were few media and other research reports and the contexts were important and could not be discounted (Patton, 1990). The interview guide was adapted from a similar study conducted in Australia (Seet and Graves, 2010b).

As we did not have access to an official register or database of the population, a non-probability convenience sampling process based on snowballing was used as this offered a better solution to the problem of data collection among hidden groups (Van Meter, 1990).

For triangulation purposes and also to investigate their role in the PE engagement process, interviews were also conducted with various professional advisers to the Singapore Chinese SMFEs. A content analysis of the interview data revealed themes associated with the engagement of PE by the Singapore Chinese SMFEs.

Respondent profile

A profile of the Singapore Chinese SMFEs is shown in Table 8.1.

Findings

The interviews support the earlier theories that there are major empathy and knowledge gaps among SMFE owners when it comes to engaging with the PE community.

Empathy gaps

Finding out the attitudes towards PE among SMFE owners was an important part of the interviews. These questions were generally more open-ended than the ones on knowledge of PE. An example of an empathy-related question is: 'How do you feel about PE involvement in family businesses?'

Table 8.1 Overview of the five SMFEs

Item	*SMFE 1*	*SMFE 2*	*SMFE 3*	*SMFE 4*	*SMFE 5*
Industries	Infrastructure and electrical supply	Publishing	Construction	Commodities trading	Lifestyle
Gender of SMFE owner	M	M	F	M	F
Age of firm (years)	25	37	10	57	19
No. employees	50	9	10	30	5
Generation	First	First /second	First	Third	First
Succession plan in place	No	Yes	Yes	Yes	No
Annual turnover (SGD)	SGD 20–50M	SGD 1–5M	SGD 1–5M	SGD 20–50M	SGD <1M

In terms of empathy, three sub-themes emerge. First, there is a fear of losing control among SMFE owners. This is illustrated in the extracts of some of the interviews below.

> I would prefer not to include outsiders in my family business … (the main) risks (are) losing control to these firms as well as releasing proprietary information to outsiders.
>
> (SMFE 3)

> I have seen how my friends' companies lose their freedom and control and they are slogging to keep up with the management team. It also means they have lost freedom to do whatever they like at their own time, like going out for coffee time, even breakfast at 11 a.m.
>
> (SMFE 4)

> I am open to the idea of venture capitalists and private equity but (they) must be prepared to give (me) management control … (the main) risk (is to) lose control over my business.
>
> (SMFE 4)

This focus on retaining control is a common theme among family businesses (Adler and Gunderson, 2008; Tanewski and Carey, 2007). In our discussions with the SMFE owners, it became apparent that most of them were not aware that PE firms often take control of the firms they invest in.

Second, there is the issue of trust. Of the five SMFE owners interviewed, only one seemed to have a positive opinion of PE. This is illustrated in the extracts of some of the interviews below.

> I feel that top management should comprise family members, as they know the business the best, having been in the line for so long (the more senior members) and having grown up learning about the business (the younger ones). The key is trust; the trust that a family has cannot be underestimated. I feel that when you have a family that works together effectively, and puts the good of the family above the interest of self, a family business beats a professionally run one any time.
>
> (SMFE 2)

> It is a matter of trust. I trust my family members that they will perform in the best interest of the company. Like I mentioned before, it would be very hard to give control of my business to outsiders and also to trust them in what they are doing without my questioning which may then lead to conflicts. In the long run, it may not be healthy to the business.
>
> (SMFE 1)

The importance of trust is also a common finding among family businesses, especially small family businesses (EVCA, 2005; Wu *et al.*, 2007). While non-family members may be seen as less trustworthy than family ones, despite material that indicate the positive influence of PE (Wang and Ahmed, 2007), it is likely that the largely negative image of the PE world as portrayed in mainstream media has reinforced the distrust (Davidsson, 2004; Schoenberger, 2002).

Third, reinforcing the lack of trust is the lack of commitment to understanding the nature and potential advantages of PE, an issue which is explored in greater detail in the next section. The Singapore Chinese SMFE owners do not seem to be open to devoting time, energy and resources in engaging with PE. Some comments are as follows:

> I have not gone for any courses. There is no time in our business to attend talks or courses as we are very hands on in the business.
>
> (SMFE 3)

> I have not read any books or materials (on private equity). Reason is lack of time. The business is moving every day and I am involved overseeing the business so there is hardly time to be involved in reading up. I would rather use the time to source for useful suppliers or customers or to expand my business plans.
>
> (SMFE 1)

> To me, it sounds like they engage in deals that amount in millions which I think my company has not reached. So, it's the bigger companies that are involved more in this sector.
>
> (SMFE 5)

It is understandable that SMFE owners have other, more pressing business-related concerns than to devote resources and effort to learning more about and engaging with the PE community (Helfat, 2007; Kaplan, 2000). It is also not unexpected as the five Singapore Chinese SMFEs that were studied currently do not have any upcoming succession concerns and three of them have succession plans that involve handing over the business to the next generation. However, of the two SMFEs that indicated they did not have succession plans, at least one of them noted that the likely end-state will be to sell the business. It is of concern here that if they do not make the effort to explore PE options, their means for exiting the business will be limited.

Knowledge gaps

The study found evidence of two areas whereby the Singapore Chinese SMFE owners were found to be lacking in knowledge of the PE sector. First, the SMFE owners did not fully understand basic concepts of PE. The semi-structured interviews asked them three questions based on common actions among PE firms when engaging with family businesses (Table 8.2):

1 Can you describe what you understand by a management buy-out (MBO)?
2 Can you describe what you understand by a management buy-in (MBI)?
3 Can you describe what you understand by a buy-in management buy-out (BIMBO)?

None of the SMFE owners answered all three questions correctly. In two of the cases they simply responded that ‘I am not sure what these mean.’ There also seems to be confusion on other fundamental concepts e.g. the difference between debt and equity. For example, one respondent saw PE as a provider of loans as follows:

> I understand all the offers and proposals put forward. I do not have any concerns. I know what they are talking or offering to me as I have gone for business talks, seminars and through peer sharing derived sufficient knowledge to handle these propositions … private equity always comes up with new systems structuring new funding/structure loans.
>
> (SMFE 4)

Reinforcing the findings of lack of enthusiasm above is the view that attempting to understand these basic concepts in dealing with PE is too difficult. As one respondent put it:

Table 8.2 Correct/incorrect responses to MBO, MBI and BIMBO question

Item	*SMFE 1*	*SMFE 2*	*SMFE 3*	*SMFE 4*	*SMFE 5*
MBO	✓	✗	✓	✗	✗
MBI	✗	✗	✓	✓	✗
BIMBO	✗	✗	✗	✗	✗

> I do not have very high education levels and have not heard such terms. I think education plays a part in knowing such financial terms and tools. For me, it is running a simple business and through experience, to run it in the most profitable way and not based on theories.
>
> (SMFE 5)

This finding is unsurprising as this knowledge-gap is not limited to family firms and is quite representative of all small businesses and start-ups (De Clercq *et al.*, 2006; Zider, 1998).

Second, although the majority of the Singapore Chinese SMFE owners acknowledged that they needed to learn more, they did not fully buy into the idea that they would engage professional advisers or get their trade associations to help bridge their knowledge gaps. We asked them three questions:

1. Have your professional advisers suggested private equity options for your business? Why and why not?
2. Have you discussed private equity options with your trade association and/or family business association?
3. Describe what other sources of information and education on the private sector that you have looked at?

Some responses were:

> No, we do not employ professional advisers … we feel that we are able to cope sufficiently well on our own.
>
> (SMFE 2)

> Never brought it up. They may feel that our profits are not big enough.
>
> (SMFE 5)

> My professional adviser concentrates on getting their jobs done, which is auditing and accounting for our company. Unless we are on very close terms, if not, I do not think it would be the place of my auditors to suggest private equity options for my company unless I ask about it.
>
> (SMFE 3)

While some of them attended talks organized by government agencies, e.g. SPRING Singapore, none of them mentioned any specific educational initiatives by their respective trade associations. This finding may be more significant among family firms as there have been initiatives over the last decade or so to encourage start-ups to capitalize on networks, alliances and other intangible resources available to build up their entrepreneurial capabilities (Alvarez and Barney, 2000, 2002).

Summary of findings from Singapore Chinese SMFEs

In general, given the effectiveness of the population control policies with other factors on reducing the fertility rate over the years, family businesses in Singapore are facing issues of succession. We set out to establish whether there were any empathy and knowledge gaps among Singapore Chinese SMFE owners in terms of dealing with PE. We found evidence of three main empathy gaps: (1) the fear of losing control; (2) the lack of trust of outsiders; and (3) the lack of enthusiasm to engage with the PE sector. We also found that there are two main knowledge gaps among Singapore Chinese SMFE owners: (1) the lack of understanding of basic concepts of PE; and (2) an indifferent attitude towards using professional advisers, trade associations and/or government resources to bridge that gap. In the next section we extend our findings to show why they may be applicable beyond Singapore, especially in China and Australia, which face similar contexts of rapidly ageing populations that may be having an impact on family businesses.

Lessons for China

Socio-economic drivers for inter-generational transition issues for SMFEs in China

The phenomenon of ageing does not only apply to more developed Asian economies like Singapore (*The Economist*, 2009). The United Nations, in 2009, conducted research on ageing and found that it was a global issue, with the older population growing faster than the total population in almost all regions of the world (United Nations, 2009). The UN estimated that 737 million people were aged 60 years or over and constituted the 'older population' of the world, nearly two-thirds of whom lived in developing countries. Their number is projected to increase to two billion in 2050, by which time older persons will outnumber children (persons aged 0–14 years). Because of the one-child policy, which has been in place for about 30 years, China's population is ageing faster than those of developed countries (Guo and Marinova, 2006). Figure 8.3 shows the population pyramids of Singapore as compared to China, while Figure 8.4 shows the relative population size trends.

From the diagrams, China has a population that is ageing rapidly; given that the one-child policy started a few years after Singapore's population planning initiative in the early 1970s, there is about 5–10 years of lag in terms of China feeling similar effects to that of Singapore. More critically, given that the birth and fertility rates have slowed down in China significantly, the mainland Chinese population will not only slow down but reverse from about 2030 onwards, much earlier than Singapore.

While much of the present research on the impact of ageing in China focuses on the social and economic implications (Guo and Marinova, 2006; Zuo and Yang, 2009), we believe that this will also affect the upcoming inter-generational

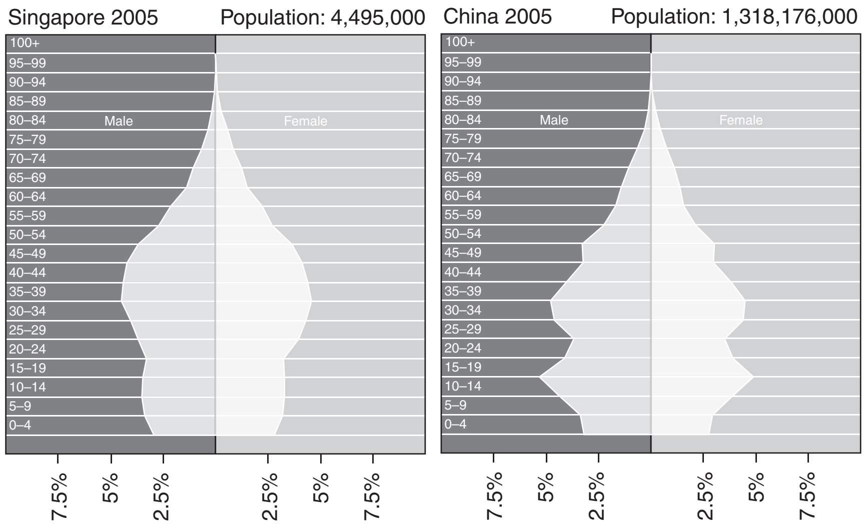

Figure 8.3 Population pyramids of Singapore (left) and China (right) as at 2005 (source: United Nations, 2009).

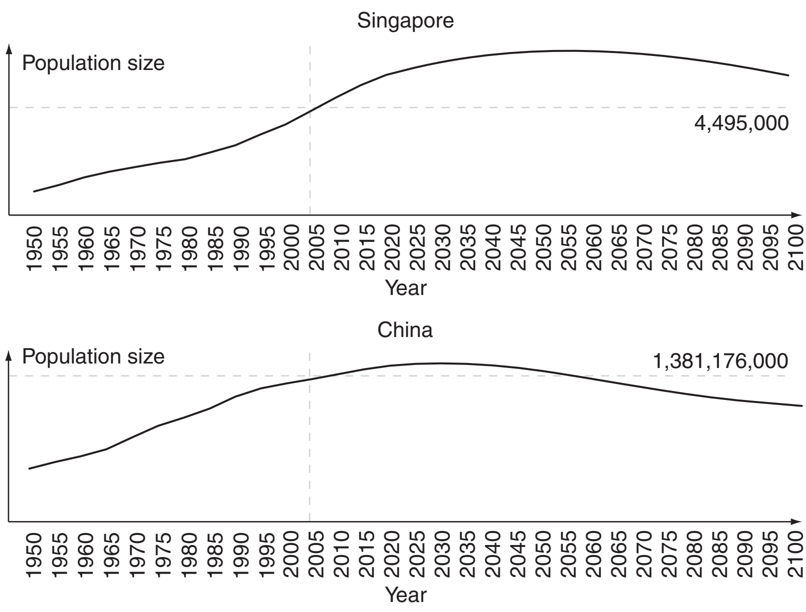

Figure 8.4 Population trends of Singapore (top) and China (bottom) (source: United Nations, 2009).

transition for mainland Chinese family businesses, especially the many that were started since the beginning of the economic reforms from 1978 onwards. This means that in the next 10–20 years, it is expected that some of the founders who started businesses in China following economic reforms that began in the late 1970s will want to hand-over to the next generation, but that there will be limited successor options. If, as suggested earlier for Singapore, the scale of these problems suggests that not all family business owners in China can look forward to alternative traditional exit options such as trade sales, then exits via PE, e.g. through MBOs, should be explored.

Inter-generational transition issues for SMFEs in China

In a recent study on children of family business owners in China, it was found that only a small portion of offspring (36 per cent of the survey respondents) intended to join their parents' businesses, let alone take over the family business (Wang and Jia, 2009). The study found that among potential successors, the most important factor influencing their intentions to succeed their parent(s) in the family business was whether there was an opportunity in the business to allow them to 'aspire to reach high professional position in [their] career'. Given that the parents of these offspring operated family businesses that employed between 21 and 500 people, the authors note that this would be difficult:

> 'Therefore, it would be a great challenge for the Chinese family business owners who intend to transfer their enterprises to the heir. Based on the findings, we can predict that only a small portion of family businesses could carry out an inside succession smoothly, while the others have to decide when and how to sell the company shares, or employ outsiders to manage the firm.
>
> (Wang and Jia, 2009: 4)

Compounding this is the widening generation gap between parents and children born after the implementation of the one-child policy (Fowler *et al.*, 2010).

Potential of PE investment in family firms in China

China's rapid economic growth has led to an equally rapid development of the alternative investment market that has started to invest in the many growth opportunities in the country. While the first domestic venture capital/PE firm was only set up in 1986, the PE industry grew rapidly after 1998 following the introduction of specific policies to promote such investments by the Chinese government (Batjargal and Liu, 2004). The result is that the Chinese PE market is now the largest in the Asian region with almost one-third of investments or US$122 billion out of US$376 billion of all capital under management in Asia (AVCJ Research, 2012). This compares with only US$32 billion for Singapore (SVCA, 2013), which suggests that the Chinese market for venture capital and PE is at least ten times larger than the size of the Singapore market.

Furthermore, research by KPMG in the PE sector in China has found that while growth capital will continue to be the predominant form of investment in Chinese targets in the near future, PE investors have expressed a rising interest in buy-out activity (KPMG, 2009). This may reflect growing confidence of investors in company management, more realistic valuations and maturity in China's mergers and acquisitions sector (Figure 8.5).

This is reinforced by the potential growth of SMFEs in the various industries in China. As noted above, PE investors generally look to invest in firms in growth industries. Due to the huge domestic market in mainland China, family businesses in China have much more growth potential when compared to family businesses set up by Chinese overseas (Zhang and Ma, 2009). As recent research shows, it is highly likely that the Chinese PE sector will rapidly catch up with more mature economies like Singapore and Australia in terms of investments in family businesses over the coming years (EYGM, 2014) (Figure 8.6).

Furthermore, recent media reports note that Chinese cities are now engaged in fierce competition to lure PE firms to set up operations in their locations (Chen and Zheng, 2010). Big cities like Shanghai, Chongqing and Beijing have been doing deals with big PE firms like Blackstone, Carlyle and TPG. The belief is that luring a PE firm to set up in the city would bring not only prestige and access to foreign investment funds for domestic projects, but also jobs. According to the mayor of Chongqing, PE 'is the crown jewel of the investment industry' (Chen and Zheng, 2010). PE firms have been offered 'dowries' which may include waiver of set-up fees, financial subsidies and pro-investment policies.

In spite of these trends, there has been little research conducted on how SMFEs in China perceive PE and vice versa.

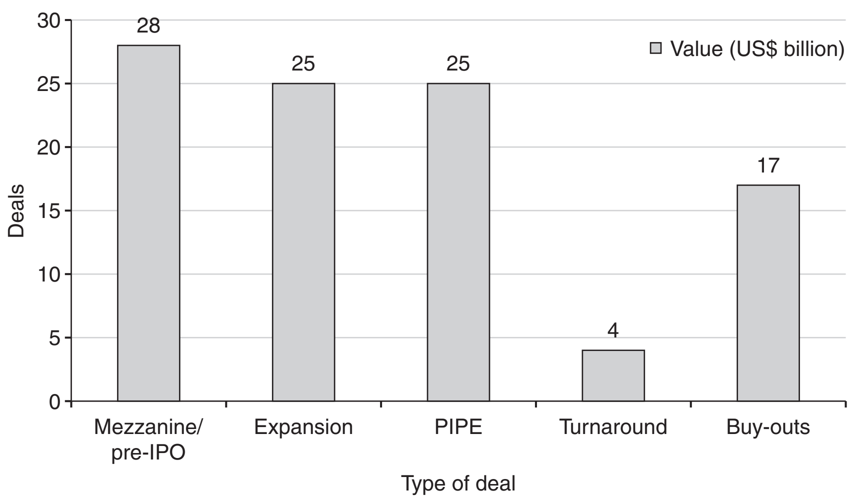

Figure 8.5 Types of deals done by private equity firms in China (2005–2010) (adapted from Ahn *et al.*, 2011).

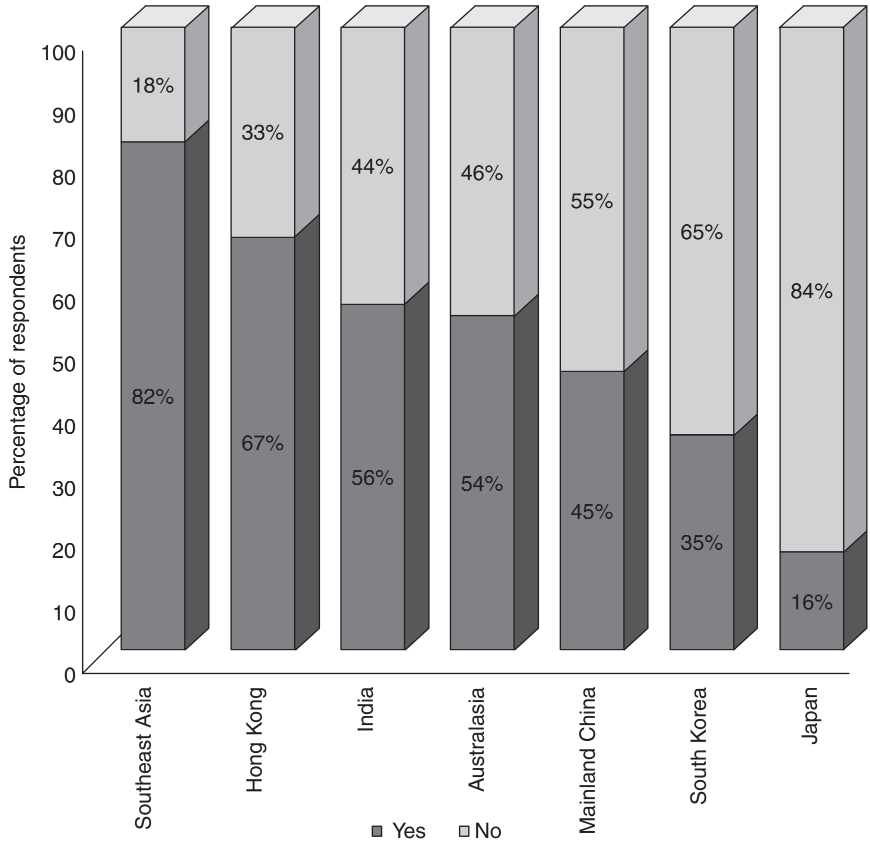

Figure 8.6 Perceptions among PE investors of investment activity growth among family-owned businesses in 2014 (source: EYGM, 2014).

Lessons for Australia

Socio-economic drivers for inter-generational transition issues for Australian SMFEs

Although Australia has not had a deliberate population control policy, there are similar demographic trends, and the main reasons for the upcoming succession problem for Australian SMFEs are the socio-economic trends of an ageing population combined with a lower birth and fertility rate.

As shown in Figure 8.7, the Australian population and workforce is ageing and has been doing so since the early 1990s.

This trend has resulted in people working for longer and rising retirement ages. There are many causes for this (e.g. people are healthier, a shift from manufacturing to services in the economy), but the most notable long-term trend

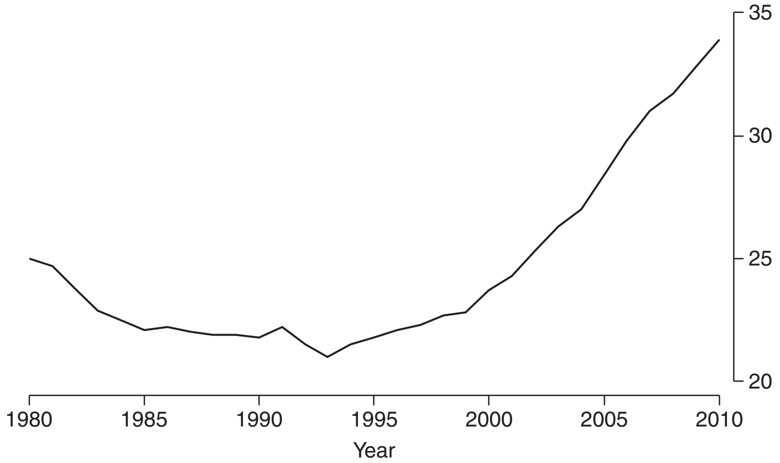

Figure 8.7 Australian labour force participation of people aged 55 years and over – 1980–2010 (source: ABS, 2010a).

has been the stabilization and decline in the birth and fertility rates as seen in Figures 8.8 and 8.9.

To overcome some of the problems of an ageing workforce, the Australian government has undertaken policy reform, such as gradually increasing the qualifying age for the government pension (to be 67 years of age by 2023). The Australian government has kept up a very positive immigration policy, largely driven by growth in the Temporary Business (Long Stay) migrants, including full fee paying international students and higher levels of skilled temporary long-term migration (see Figure 8.10) (ABS, 2009).

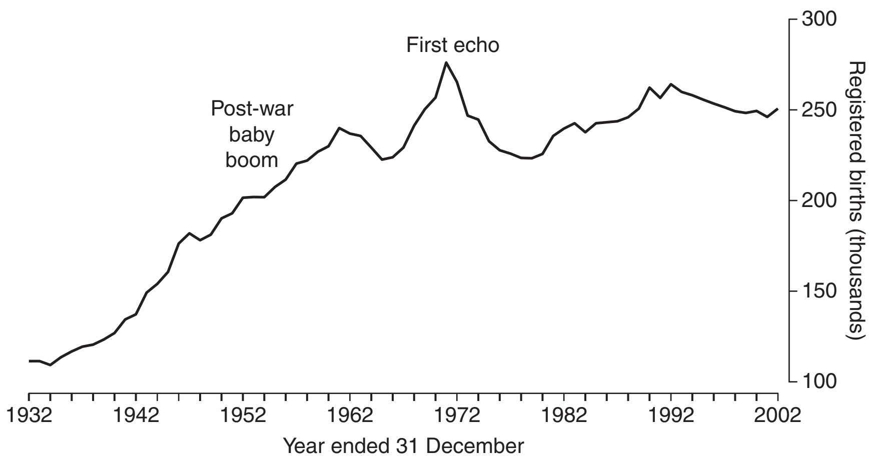

Figure 8.8 Number of registered births in Australia (source: ABS, 2010a).

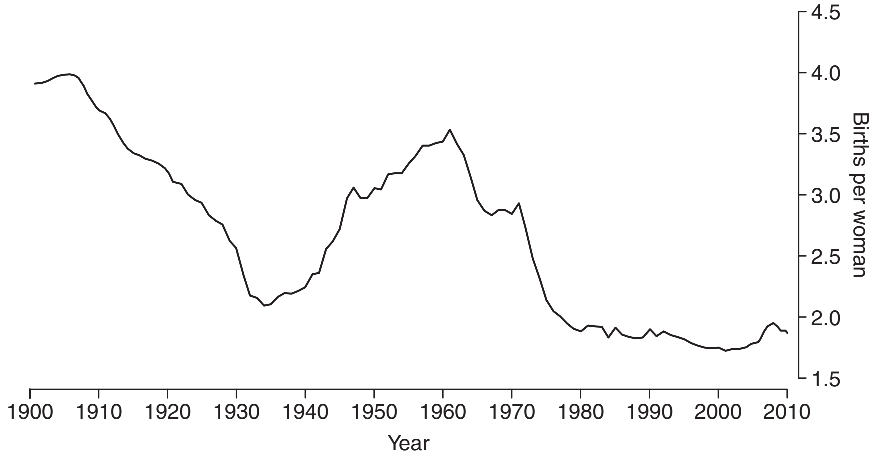

Figure 8.9 Total fertility rate in Australia: 1900–2012 (source: ABS, 2012).

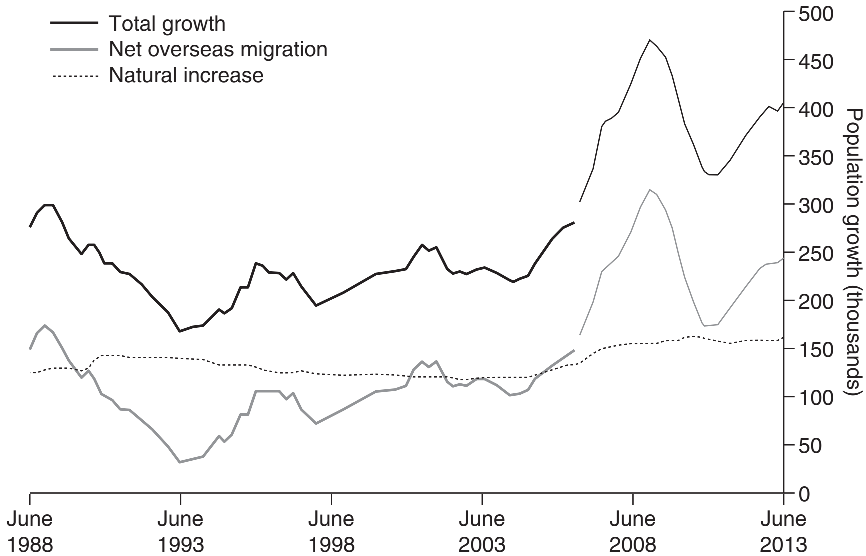

Figure 8.10 Components of population growth in Australia (source: ABS, 2013).

Notes
Annual components calculated over each quarter.
Estimates for June quarter 2002 onwards and preliminary.
NOM estimates have been calculated using a range of methods over the period, and include a break in series at September quarter 2006.
Estimates for September quarter 2012 onwards are preliminary.

Inter-generational transition issues for SMFEs in Australia

However, using immigration is not really a viable option for family business owners, and given that many of the founder-owners are from the baby-boomer generation (Figure 8.11), around 60 per cent of family business owners plan to retire by 2016 as part of the general trend of retiring baby boomers (KPMG and FBA, 2007).

Although over 55 per cent hope to pass on the business to the next generation, it is estimated that only 25–35 per cent will be successful in doing so because of a lack of interested and/or suitable family successors (Smyrnios and Dana, 2006). This suggests that there is an impending crisis where many SMFEs will have difficulties in successfully exiting or passing on the business in the near future.

Potential of PE investment in family firms in Australia

Because PE has increasingly been used in the ownership transition of family firms in developed countries, especially in Europe and North America, there is growing interest in whether PE investors can provide a practical solution to the upcoming succession crisis among SMFEs in Australia (Seet and Graves, 2010a). However, while there was sustained interest among PE investors to get involved in the SMFE sector, unlike the rapid expansion of the PE sector in China, the PE sector has experienced a significant contraction in Australia. Recent research from AVCAL show that although fundraising in the PE sector has grown by 54 per cent in FY2012 as compared to FY2011, with particular resilience in the small- and mid-market segments, PE investments fell by 25 per cent and only 28 PE managers completed new deals in FY2012 (see Figure 8.12), the lowest number of participants in a decade (AVCAL, 2012).

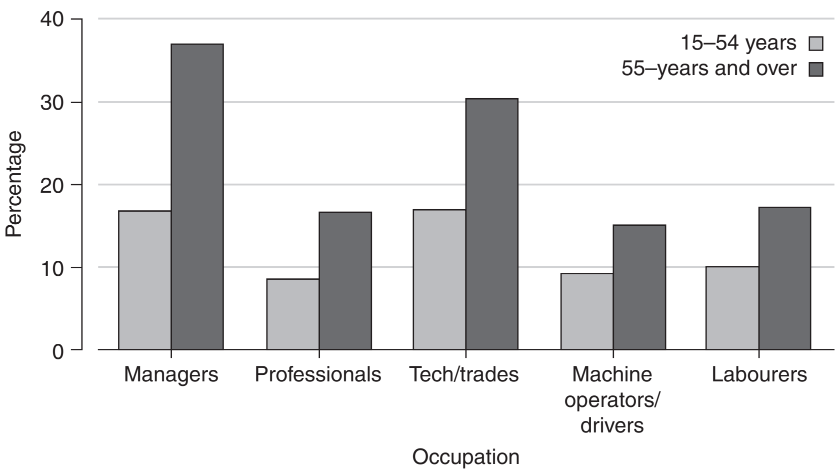

Figure 8.11 Proportion of Australian owner managers and selected occupations (2010) (source: ABS, 2010b).

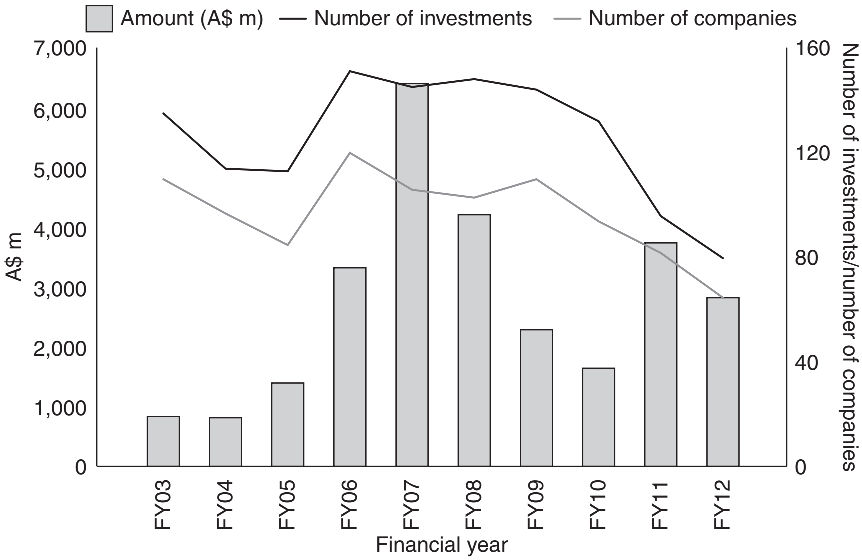

Figure 8.12 Australian PE funds raised by fiscal year (in A$ millions) (source: AVCAL, 2012).

In terms of interest among family business owners for using PE, PricewaterhouseCoopers (PwC), in collaboration with AVCAL, has recently conducted similar research and found

> that private equity (PE) may have something of an image problem. With a significant proportion of companies surveyed either planning investments or ownership succession (or both), there appear to be widespread misconceptions about what private equity is and the role it can play for owners considering investments and/or succession.
>
> (PwC, 2012b: 3)

In this research, only 5 per cent of respondents were considering PE as a source of investment (see Figure 8.13). This is very similar to the 4 per cent of family firms considering PE as a source of investment that PwC found in a much more detailed study of a small group of 50 selected firms (PwC, 2012a).

PwC's survey focused on firms with revenues of approximately A$10 million to A$100 million per year. Of these, only 10 per cent of respondents had any experience with PE, with 22 per cent admitting that they did not know enough about PE as an option (PwC, 2012b). This mirrors findings from earlier exploratory research in Australia that focused on even smaller firms, namely SMFEs, which found that for these firms, many would look for advice on engaging with PE through their business advisers and especially through their accountants, their preferred advisers (Seet and Graves, 2010b).

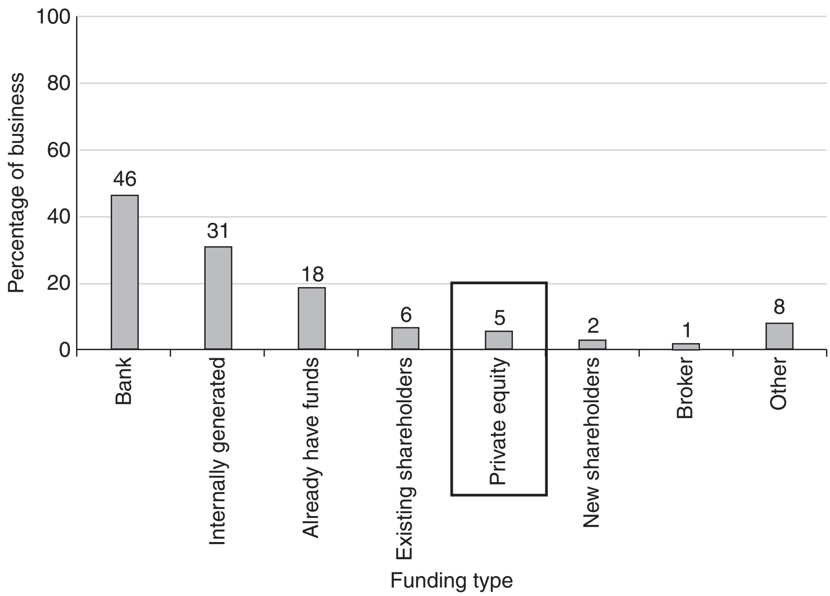

Figure 8.13 Percentage of businesses considering different types of funding (source: PwC, 2012b).

Note
Base: planning investment (*n* = 342).

Conclusion, further research and policy implications

Regardless of the potential opportunities for PE to provide solutions to the upcoming succession crisis among SMFEs in Singapore, our exploratory research suggests that SMFE owners are ill-prepared or unwilling to explore such opportunities. There appears to be significant gaps in knowledge with regard to the PE sector in general, and specifically how PE can provide owners with alternative options to exit as owners. It is also evident that even if owners develop a greater understanding of PE, they are unlikely to engage with this type of financing largely because of their overriding desire to preserve family control. Given the fact we are interested in the use of PE when owners may be willing to forgo family control (i.e. exit as owners), efforts should be directed to educating owners looking to exit on how the PE sector can provide alternatives to traditional exit routes such as a trade sale.

The findings of the research on Chinese SMFEs in Singapore correlates with exploratory research in Australia that indicates there are significant barriers that exist between family business owners and PE providers which create not only knowledge and empathy gaps, but also finance gaps between the two parties, i.e. PE investment in SMFEs may be a theoretical possibility but not necessarily a practical reality in the Australian context (Seet and Graves, 2010b). As there is little research in mainland China about the barriers to and opportunities for SMFEs to access PE, further research needs to be conducted to understand whether these empathy and knowledge gaps exist; specifically, are there any aspects that are peculiar to the mainland Chinese context.

In terms of policy, given that the research findings indicate that if policy-makers and the PE community want to assist SMFEs by giving them alternative exit and harvest options, they will have to work hard to address these empathy and knowledge gaps. Some suggestions for initial action that may assist in bridging these identified empathy and knowledge gaps between SMFE business owners and the PE sector, which are applicable not only in Singapore but also in China and Australia, are:

- Target accountants and professional advisers to family businesses as part of the ongoing professional upgrading of skills and knowledge of the PE sector.
- The PE community must market itself differently when it comes to dealing with family businesses as they have different concerns to the traditional high-technology start-up firms.
- Besides conducting educational activities, government agencies, trade associations and family business associations should actively promote interaction and confidence-building activities between the SMFE owners and the PE.
- Government agencies, trade associations and family business associations should actively develop innovative ways to educate SMFE owners on the expectations of the PE community and vice-versa.

References

ABS. 2009. *Australian Demographic Statistics*. Canberra: Australian Bureau of Statistics.

ABS. 2010a. *1980–2010 Labour Force Survey*. Canberra: Australian Bureau of Statistics.

ABS. 2010b. *Australian Social Trends September 2010*. Canberra: Australian Bureau of Statistics.

ABS. 2012. *Year Book Australia 2012*. Canberra: Australian Bureau of Statistics.

ABS. 2013. *Australian Demographic Statistics, June Quarter 2013*. Canberra: Australian Bureau of Statistics.

Adler, N.J. and Gunderson, A. 2008. *International Dimensions of Organizational behaviour* (5th edn). Eagan, MN: Thomson/South-Western.

Ahn J., Bhagat, C., Honda, K., Kwan, I., Lind, F., Pandit, V., Poullet, J.-M., Roy B. and Ye T. 2011. Private equity Asia-Pacific: rebounds, glocalization, and other tales. In *Private Equity & Principal Investing*. McKinsey & Company, Inc.

Alvarez, S.A. and Barney, J.B. 2000. Entrepreneurial capabilities: a resource-based view. In G.D. Meyer and K.A. Heppard (eds), *Entrepreneurship as Strategy: Competing on the Entrepreneurial Edge*, pp. 63–81. London: Sage.

Alvarez, S.A. and Barney, J.B. 2002. Resource-based theory and the entrepreneurial firm. In M.A. Hitt, R.D. Ireland, S.M. Camp and D.L. Sexton (eds), *Strategic Entrepreneurship: Creating A New Mindset*, pp. 89–105. Oxford: Blackwell.

AVCAL. 2012. *2012 Yearbook*. Sydney: Australian Private Equity & Venture Capital Association.
AVCJ. 2001. *The 2001 Guide to Venture Capital in Asia*. Hong Kong: AVCJ Group Limited.
AVCJ Research. 2012. *Asian Private Equity and Venture Capital Report 2012*. Hong Kong: AVCJ Group.
Bachkaniwala, D., Wright, M. and Ram, M. 2001. Succession in South Asian family businesses in the UK. *International Small Business Journal*, 19(4): 15–27.
Batjargal, B. and Liu, M. 2004. Entrepreneurs' access to private equity in China: the role of social capital. *Organization Science*, 15: 159–172.
Bruton, G.D., Ahlstrom, D. and Singh, K. 2002. The impact of the institutional environment on the venture capital industry in Singapore. *Venture Capital: An International Journal of Entrepreneurial Finance*, 4(3): 197–218.
BVCA. 1999. *Report on Investment Activity*. London: British Venture Capital Association.
Carey, P., Simnett, R. and Tanewski, G. 2005. Providing business advice for small to medium enterprises. In *CPA Australia Business Management Reports*. Melbourne: CPA Australia.
Chen, H. and Zheng, H. 2010. China's high-stakes race for PE 'crown jewel'. *Caixin Online*, 2 September 2010.
Cheng, L.-K. 1989. Post-independence population planning and social development in Singapore. *GeoJournal*, 18(2): 163–174.
Chu, P. and Hisrich, R.D. 2001. Venture capital in an economy in transition. *Venture Capital: An International Journal of Entrepreneurial Finance*, 3(2): 169–182.
Davidsson, P. 2004. *Researching Entrepreneurship*. New York. Springer.
De Clercq, D., Fried, V.H., Lehtonen, O. and Sapienza, H.J. 2006. An entrepreneur's guide to the venture capital galaxy. *Academy of Management Perspectives*, 20(3): 90–112.
Department of Statistics Singapore. 2013. *The Singapore Economy*. Singapore: Government of Singapore.
The Economist. 2009. A survey of ageing.
Economist Intelligence Unit and Citibank. 2006. Not keeping it in the family: Most small businesses want professional managers to run firms in the long run – survey. *Today*.
European Venture Capital Journal. 1999. Singapore venture capitalists pile into hi-tech sector. *European Venture Capital Journal*, 64: 15.
EVCA. 2001. *Survey of the Economic and Social Impact of Management Buyouts & Buyins in Europe*. Zaventem, Belgium: European Private Equity & Venture Capital Association.
EVCA. 2005. *The Contribution of Private Equity to the Succession of Family Business in Europe*. Zaventem, Belgium: European Private Equity & Venture Capital Association.
EYGM. 2014. *Asia Pacific Private Equity Outlook 2014*. Singapore: EYGM.
Fowler, A.R., Jie Gao and Carlson, L. 2010. Public policy and the changing Chinese family in contemporary China: the past and present as prologue for the future. *Journal of Macromarketing*, 30(4): 342–353.
Gallo, M.A. and Vilaseca, A. 1996. Finance in family business. *Family Business Review*, 9: 387–401.
Gambe, A. 2000. *Overseas Chinese Entrepreneurship and Capitalist Development in Southeast Asia*. Basingstoke: Palgrave Macmillan.
Gasson, C. 1999. The private equity market. In C. Gasson and A. Jolly (eds), *Corporate Finance Handbook*. London: Kogan Page.

Gersick, K.E. 1997. *Generation to Generation: Life Cycles of the Family Business*. Boston, MA: Harvard Business School Press.

Guo, X. and Marinova, D. 2006. Population ageing and sustainability in China: comparisons with Australia. *ACESA 2006 International Conference*, Melbourne, Victoria University.

Gurd, B. and Thomas, J. 2006. Finance managers in family-owned small-to-medium enterprises. In *CPA Australia Business Management Reports*. Melbourne: CPA Australia.

Harvey, M. and Evans, R. 1995. Forgotten sources of capital for the family-owned business. *Family Business Review*, 8(3): 159–176.

Helfat, C.E. 2007. *Dynamic Capabilities: Understanding Strategic Change in Organizations*. London: Blackwell Publishing.

Hindle, K. and Lee, L. 2002. An exploratory investigation of informal venture capitalists in Singapore. *Venture Capital: An International Journal of Entrepreneurial Finance*, 4(2): 169–177.

Hofer, C.W. and Charan, R. 1984. The transition to professional management: mission impossible? *American Journal of Small Business*, 9(1): 1–11.

Holstein, J.A. and Gubrium, J.F. 1997. Active interviewing. In D. Silverman (ed.), *Qualitative Research: Theory, Method and Practice*. London: Sage.

Howorth, C., Westhead, P. and Wright, M. 2004. Buyouts, information asymmetry and the family management dyad. *Journal of Business Venturing*, 19(4): 509–534.

Joseph, M. 1999. Trends in private equity. In C. Gasson and A. Jolly (eds), *Corporate Finance Handbook*, pp. 69–76. London: Kogan Page.

Kaplan, D. 2000. *Structural Equation Modeling: Foundations and Extensions*. London: Sage Publications.

Koh, W.T. and Koh, F. 2002. Venture capital and economic growth: an industry overview and Singapore's experience. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=355920.

KPMG. 2009. Private equity in China. In *Market Sentiment Survey*. Hong Kong: KPMG.

KPMG. 2012. *Family Business in Singapore*. Singapore: CPA Australia.

KPMG and FBA. 2007. *KPMG and Family Business Australia Survey of Family Businesses 2007*. Geelong: Deakin University.

Lee, J. 2006. Impact of family relationships on attitudes of the second generation in family business. *Family Business Review*, 19(3): 175–191.

Lee, J. and Chan, J. 1998. Chinese entrepreneurship: a study in Singapore. *Development*, 17(2): 131–141.

Lee, S.-Y. and Loh, G. 1998. *Beyond Silken Robes: Profiles of Selected Chinese Entrepreneurs in Singapore*. Singapore: Times Academic Press.

Lockett, A. and Wright, M. 2002. Venture capital in Asia and the Pacific Rim. *Venture Capital: An International Journal of Entrepreneurial Finance*, 4(3): 183–195.

Maherault, L. 2004. Is there any specific equity route for small and medium-sized family businesses? The French experience. *Family Business Review*, 17(3): 221–235.

Menkhoff, T. and Gerke, S. (eds). 2002. *Chinese Entrepreneurship and Asian Business Networks*. London: RoutledgeCurzon.

Pan, L. 1990. *Sons of the Yellow Emperor: The Story of the Overseas Chinese*. London: Secker & Warburg.

Patton, M.Q. 1990. *Qualitative Evaluation and Research Methods* (2nd edn). London: Sage.

Poutziouris, P. 2001. The views of family companies on venture capital: empirical evidence from the UK small to medium-size enterprising economy. *Family Business Review*, 14(3): 277–291.

Poutziouris, P. 2002. The financial affairs of smaller family companies. In D.E. Fletcher (ed.), *Understanding the Small Family Business*, pp. 111–126. London: Routledge.
Poutziouris, P., Michaelas, N., Chittenden, F. and Sitorious, S. 2000. The financial structure, behaviour and performance of SMEs: family and private companies. Paper presented at the Small Business and Enterprise Development Conference, Manchester.
PwC. 2012a. *Growing the Future of Australia's Family Businesses*. Sydney: PricewaterhouseCoopers.
PwC. 2012b. *Private Business Barometer: Private Equity Supplement*. Sydney: PricewaterhouseCoopers.
Ray, D.M. 1991. Venture capital and entrepreneurial development in Singapore. *International Small Business Journal*, 10(1): 11–26.
Reier, S. 2006. When blood is thicker than money: family-run firms gain favor with investors seeking long-term values. *International Herald Tribune*: 14.
Robbie, K. and Wright, M. 1996. *Management Buy-Ins: Entrepreneurship, Active Investors, and Corporate Restructuring*. Manchester: Manchester University Press.
Romano, C.A., Tanewski, G.A. and Smyrnios, K.X. 2001. Capital structure decision making: a model for family business. *Journal of Business Venturing*, 16(3): 285–310.
Saxenian, A. 1999. *Silicon Valley's New Immigrant Entrepreneurs*. San Francisco, CA: Public Policy Institute of California.
Schoenberger, C.R. 2002. Vulture capital scavengers pick through investment portfolios. *FORBES*, 169(1): 38–39.
Scholes, L., Westhead, P. and Burrows, A. 2008. Family firm succession: the management buy-out and buy-in routes. *Journal of Small Business and Enterprise Development*, 15(1): 8–30.
Seet, P.-S. and Graves, C. 2010a. Submission to the Commonwealth Government's Senate Economics Committee's Inquiry into Access of Small Business to Finance. In *Australian Commonwealth Government Senate Standing Committee on Economics Inquiry into Access of Small Business to Finance*. Canberra: Parliament of Australia.
Seet, P.-S. and Graves, C. 2010b. *Understanding the Barriers to and Opportunities for Access to Private Equity for Small-to-Medium-sized Family-owned Enterprises (SMFEs)*. Melbourne: CPA Australia.
Smyrnios, K. and Dana, L.E. 2006. *MGI Australia Family & Private Business Survey*. Melbourne: RMIT.
Steyaert, C. and Bouwen, R. 1997. Telling stories of entrepreneurship: towards a contextual epistemology for entrepreneurial studies. In R. Donckels and A. Mietten (eds), *Entrepreneurship and SME Research: On Its Way to the Next Millennium*, pp. 3–19. Aldershot: Ashgate.
SVCA. 2013. SVCA Awards 2013. Press release, Singapore SVCA.
Tan, W.-L. and Fock, S.-T. 2001. Coping with growth transitions: the case of Chinese family businesses in Singapore. *Family Business Review*, 14(2): 123–140.
Tanewski, G. and Carey, P. 2007. *Determinants of Value Adding Business Advice Provided By External Accountants to SME Clients*. Paper presented at the 52nd International Council for Small Business World Conference, Turku, Finland.
United Nations. 2009. *Population Ageing and Development*. New York: United Nations.
Upton, N. and Petty, W. 2000. Venture capital investment and US family business. *Venture Capital*, 2(1): 39.
Van Meter, K.M. 1990. Methodological and design issues: techniques for assessing the representatives of snowball samples. In Elizabeth Lambert (ed.), *The Collection and*

Interpretation of Data from Hidden Populations, pp. 31–33. Rockville, MD: US Department of Health and Human Services.
Wang, C.K. and Sim, V.Y.L. 2001. Exit strategies of venture capital-backed companies in Singapore. *Venture Capital: An International Journal of Entrepreneurial Finance*, 3(4): 337–358.
Wang, C.L. and Ahmed, P.K. 2007. Dynamic capabilities: A review and research agenda. *International Journal of Management Reviews*, 9(1): 31–51.
Wang, X. and Jia, S. 2009. Factors that influence offspring intentions to join the family businesses: evidence from Zhejiang, China. Paper presented at the 6th International Conference on Service Systems and Service Management.
Wright, M. 2007. Private equity and management buyouts. In H. Landstrom (ed.), *Handbook of Research on Venture Capital*, pp. 281–312. Cheltenham: Edward Elgar.
Wright, M. and Burrows, A. 2008. Entrepreneurship and management buy-outs. In M. Casson (ed.), *The Oxford Handbook of Entrepreneurship*, pp. 484–507. Oxford: Oxford University Press.
Wright, M., Thompson, S. and Robbie, K. 1992. Venture capital and management-led, leveraged buy-outs: a European perspective. *Journal of Business Venturing*, 7(1): 47–71.
Wright, M., Pruthi, S. and Lockett, A. 2005. International venture capital research: from cross-country comparisons to crossing borders. *International Journal of Management Reviews*, 7(3): 135–165.
Wright, M., Scholes, L., Ball, R., Howorth, C., Kloeckner, O., Westhead, P. and Burrows, A. 2008. A report on private equity investments in family firms across Europe. Nottingham: CMBOR.
Wu, Z., Chua, J.H. and Chrisman, J.J. 2007. Effects of family ownership and management on small business equity financing. *Journal of Business Venturing*, 22(6): 875–895.
Yeung, H. 2000. Limits to the growth of family-owned business? The case of Chinese transnational corporations from Hong Kong. *Family Business Review*, 13(1): 55–70.
Zapalska, A. and Edwards, W. 2001. Chinese entrepreneurship in a cultural and economic perspective. *Journal of Small Business Management*, 39(3): 286–292.
Zhang, J. and Ma, H. 2009. Adoption of professional management in Chinese family business: a multilevel analysis of impetuses and impediments. *Asia Pacific Journal of Management*, 26(1): 119–139.
Zider, B. 1998. How venture capital works. *Harvard Business Review*, 76(6): 131–139.
Zuo, X. and Yang, X. 2009. The long-term impact on the Chinese economy of an aging population. *Social Sciences in China*, 30(1): 197–208.
Zutshi, R.K., Tan, W.L., Allampalli, D.G. and Gibbons, P.G. 1999. Singapore venture capitalists (VCs) investment evaluation criteria: a re-examination. *Small Business Economics*, 13(1): 9–26.