KPMG
cutting through complexity

FBA
Family Business Australia

Stewards: Moving forward, moving onward

KPMG and Family Business Australia's Family Business Survey 2011

Contents

Introduction

Welcome to *Stewards: Moving Forward, Moving Onward*

KPMG and Family Business Australia's Family Business Survey 2011

Family businesses penetrate just about every nook and cranny of the Australian economy. They drive innovation and employment. Their resiliency and adaptability make them a buffer against economic shocks and dislocations.

For all its importance, knowledge and understanding of family businesses in Australia is limited. This biennial survey — a joint effort of KPMG and Family Business Australia (FBA) — demonstrates a commitment to rectify that void. This current study, as well as others conducted by KPMG and FBA over the past decade, have made a valuable contribution to the understanding of family businesses, their owners and the attributes that equate to their success.

This survey, conducted during April and May 2011, follows the experience of 658 family enterprises from across Australia. Participants were the incumbent generation of the business. Rather than collecting and disseminating masses of dry statistical data, this year's study explores the internal dynamics of a representative cross section of Australian family businesses. The survey offers valuable insights into some of the main issues facing the family business sector today.

Succession and exit planning are important matters for most enterprises — for family businesses they can be critical. Our analysis of the survey results looks at succession and exit planning from several perspectives, including those contemplating relinquishing business ownership and control, those preparing it to be taken over, and those other family members who will be affected by these decisions.

We also consider the key causes of conflict and the challenges unique to a family enterprise that, depending upon their management, can be critical factors in the success or demise of a business.

KPMG and FBA thank all of the individuals who responded to our survey questionnaire and to those who participated in the associated discussion groups that were designed to provide texture and context for the survey results. Relevant verbatim extracts from these rich discussions are appended to the main text throughout this document.

We would also like to thank Bond University's Australian Centre for Family Business who have provided highlighted insights to complement the survey findings.

We trust our report will be of value and interest not only to those directly engaged in family businesses, but also to those financiers, advisers and regulators who deal with and support the sector.

Bill Noye
Partner
KPMG National Leader
for Family Business

Philippa Taylor
CEO
Family Business Australia

AUSTRALIAN CENTRE FOR FAMILY BUSINESS

Executive summary

Meeting the many family business challenges
Retaining control of the family business was a priority issue for more than 60 percent of survey respondents. Management succession and balancing family concerns were other prominent issues. Focus group discussion included examination of how family business values and culture help create and sustain competitive advantage and how these factors can best be leveraged.

Managing and resolving conflict
Respondents nominated future business strategy, the competence of family members working in the business and succession issues as the main sources of conflict in family businesses. Conflict and difference arise in all businesses. They are not necessarily bad and can be productive when framed as creative abrasion. Managing and resolving minor conflicts and differences effectively is seen as a key ingredient in family business success and sustainability.

Governing the family business
Family businesses typically adopt a range of formal and informal governance practices. More than half of the surveyed firms had no board or other governing body, two-thirds did not have a family council and almost as many failed to provide the family with formal feedback on business matters. Significantly, three-quarters lacked any independent assessment of management performance. Family business stewards in the early life stages of the business typically favour informal governance and control mechanisms.

Grappling with compensation issues
Fifty-one percent of surveyed firms paid family employees at the same rate as non-family employees for similar work. A quarter paid family members more. Family members typically worked longer hours than their non-family counterparts. Some family businesses are adopting a policy of 'paying the position, not the individual'. Remuneration issues can also be a source of family conflict and should be managed carefully, which was highlighted in the focus discussion groups.

Gaining an innovation edge
Most respondents believed in the need to innovate, but a much lower number were actually setting aside funds for R&D. Family firms valued their flexibility and adaptability and believed these traits encouraged innovation. Three-quarters of respondents looked for entrepreneurial skills in successor candidates.

Preparing to sell the business
Over a third of survey respondents believed that their businesses were exit or succession ready. The same proportion reported having received an offer for their businesses during the previous 12 months. Interestingly, 59 percent said they would consider selling the family business if approached by a genuine buyer.

Letting go of the business
Transitioning the family business from one generation to the next can be a complex and difficult process. The issues it seems are generational. Incumbents told us that their concern for the ability and enthusiasm of their successors was key, while the next generation believe the willingness of their incumbents to let go was a greater challenge for them both.

Facing up to the challenges of the family business

Retaining control of their family businesses emerged as a priority issue for this year's survey respondents. Other top-of-mind considerations included balancing family concerns and business interests and preparing for management succession.

More than 60 percent of our respondents nominated retaining family control of the business as a high or very high priority for them at the present time (Figure 1). In a business context, control is often equated with ownership and the ability to control decision making in the board room. However, when we raised the matter in our focus group discussions, it became clear that to many families, control was often seen as the means by which the family encouraged and preserved a desired 'culture' within the business that reflected family values and attitudes, and sustained their competitive advantage.

As one participant put it, *"control is not only about equity. It's about the management and the culture"*. It follows then that 88.5 percent of survey respondents thought their family values affected the way their businesses were conducted. Yet when asked about the transfer or communication of these values to the business, more than three-quarters said it was an informal process.

Figure 1: Issues of importance to the family business.

	% Very high	High	Moderate	Low	Very Low
Maintaining family control of the business	31	30.5	17	11	10.5
Balancing family concerns and business interests	20	39	26	8	6
Preparing and training a successor before succession actually takes place	23.5	36	20.5	8.5	11.5
Maintaining a role for the existing senior family member	11.5	29.5	21.5	16	21.5
Selecting a successor	15.5	22.5	22.5	16.5	23
Informing family of business issues	9.5	28	28	14	19.5
Compensating family members involved in the business	7.5	28	26	15	23.5
Resolving conflict among family members	14	20.5	19.5	18	28
Formalising the family role	8	21	20.5	21	29.5
Establishing a family constitution or code of conduct	8.5	18.5	19	20	34
Selecting family members for positions in the business	6	17	24	22	31
Distributing ownership among family members	7	15	22	18	38
Setting up a family foundation	7	14	21	18.5	39.5
Equity among family members, including step relations	5.5	11.5	17.5	18.5	47
Rivalry among family members	5	8	20	23.5	43.5
Dealing with rivalry among potential successors in the family	3.5	7.5	14.5	19.5	55
Buying out family members not involved in the business	2.5	5	8	17.5	66.5

An underlying theme of much focus group discussion was the way in which the culture of the family business created a degree of competitive advantage. This advantage was felt to grow from the personalisation of customer and supplier relationships, financial flexibility and resilience (the typical family business was prepared to accept a prolonged period of low or negative returns in order to execute strategies) and superior product/ service quality and innovation.

Many focus group participants also expressed concerns about cultural distillation with the appointment of an external CEO or other senior executive or board member. These outsiders often possess limited understanding of the family values and often are driven by a desire to improve short-term financial performance. Of course, the recruitment of outside managers and directors might merely signify that a firm's scale and complexity had outrun relatively informal family control practices. It might be that the business is being prepared for sale or going through significant change, necessitating an emphasis on selected financial performance metrics.

Insight: Family businesses are better able to absorb business setbacks and financial distress than their non-family counterparts. Factors at work here appear to include high levels of trust between family members engaged in the business, alignment of financial and non-financial business objectives, planning flexibility, commitment to notions of stewardship and the existence of 'patient capital'.

"I think that the owners have a perspective on where they want to take the business, that is not necessarily financially driven."

"This business is our life and our legacy. We invest our self actualisation in this business. Money is great, but it's not the only motivator for us."

"The cultural side of things is extremely important in a family business. If you bring a corporate [manager] in, you've got to teach him or her how to manage the family business. The thing that is often missed is teaching the family members how to be owners. You have to separate ownership and management."

Focus group participants

Still, many family business owners and managers certainly believe that being a family business provides them a competitive advantage. Fifty-six percent of our survey respondents agreed that being a family business had helped them deal with the post-GFC economic downturn while only 10 percent actually disagreed with this proposition (the remainder were unsure).

Insight: 'Familiness' is composed of a unique bundle of resources. This bundle comprises: reputation and experience, insight and skills (human resources), learning and decision-making (organisational resources) and relationships and networks (process resources).

Yet when asked whether family or business issues were of higher importance, 71 percent agreed business issues would always prevail and a ranking of key business strengths also found that designation as a family business was ranked very low, with less than 5 percent supporting that preposition. Respondents felt that strengths were driven by external factors such as ability to win new business, customer loyalty or strong brand and market presence (Figure 2).

Given these conflicting interests, it is little surprise then that 60 percent also find balancing family concerns with business concerns to be a high or very high priority (Figure 1).

"We appointed a non-family CEO. The challenge becomes keeping him or her in check with the family, particularly in terms of the cultural values. Even with regards to business ethics. We have a certain way of doing things."

"It's not about surviving this year, or next year, or whether we make a profit this year, or next year. We've always said that family business is differentiated by its long-term view, its 10 to 20 year decision making horizon, which I think is a testament to how different family business is to a public company."

Focus group participants

Figure 2: Key strengths of the business.

	% 2011
Ability to win business or customer loyalty	26
Strong brand or market presence	14
Product design, quality or range	11
Financial strengths and ability to access capital	9
Vision and strategy	9
Technical capabilities	7.5
Competitive pricing	7
Human resources	6.5
Designation as a family business	5
Assertive or aggressive marketing	2
Size	2
Other	1

Referring back to the key challenge of maintaining control of the family business, and where control does refer to ownership, the issues can become quite complex. For instance, as family businesses grow and mature and as ownership passes through successive family generations, the link between ownership and control/management can become increasingly enervated. This can increase if holding companies or trusts are interposed between the family owners and the operating business entities. Matters are further complicated when the accumulation and preservation of family wealth becomes a separate consideration from the operation of the family business itself.

"We've got a non-family executive chairman and CEO and he is appointing corporate type people to positions within the firm. As a family we've been seeing some of the things that have been happening and we're very concerned about the cultural impact. We think we've got a culture that is unique to us and we want to maintain that. We want to ensure that the management can share our passion."

Focus group participant

Keeping the family happy: managing and resolving conflict

Business strategy, the competence of family members working in the business, succession issues and family communication were cited as major sources of conflict in the businesses and families surveyed.

Conflict and difference are inherent in any enterprise. They are not necessarily bad. Without them, a business can become complacent, lazy and strategically sterile. Yet unresolved or poorly resolved conflicts can divert attention from important business issues, impair commercial performance and compromise the quality of business decision making.

Within a family these conflicts can be amplified. Indeed unresolved conflicts in family businesses can paralyse decision making and destroy business value. Thus it is encouraging to note that among the causes of conflict in family businesses summarised in Figure 3, those relating to mainly personal differences — sibling rivalry, the status of in-laws and intergenerational conflict — were not particularly prevalent. The most commonly cited causes of conflict involved legitimate, important business decisions, such as future strategy of the business, where differences of opinion are always likely, perhaps even desirable.

"I don't see arguments about the future strategy of the business as a bad thing. It can be helpful. There's always conflict, but that can be good, if handled constructively. For us — especially with the next generation — there might be a desire to take a different direction, but it's not a bad thing because we each bring our experience and opinion to the table."

Focus group participant

Insight: The role of strategic planning will vary greatly between family and non-family-owned firms. In non-family firms, strategic planning is usually endorsed and legitimised by owners and a board of directors, and a formal process can limit agents' discretion and establish incentive structures which reward the attainment of strategic and financial objectives.

In contrast, family-owned firms are more likely to conduct frequent, informal discussions about their business and its strategy with other family members who also own or work within the family firm. The heightened sense of 'familiness' can be a valuable source of competitive advantage, allowing the family firm to achieve the benefits of strategic planning without necessarily having to formalise the process.

Therefore, the manner in which strategy is formulated and implemented is a crucial distinction between family and non-family firms.

"Our CEO created a very clear, well thought through strategy with the focus on growth. Yet the family's emphasis is on culture and operational excellence. So there's a bit of a conflict there."

Focus group participant

Figure 3: Major reported causes of conflict in family businesses.

	% 2011
Future strategy of the business	19.5
Competence of family members working in the business	14
Succession	10.5
Lack of family member communication	10
Lack of family/non-family management communication	7.5
Remuneration	7
Sibling rivalry	6.5
Decisions about the employment of family members	6.5
Dividend policy	3.5
Inter-generational rivalry	3.5
In-laws	3
Lack of share liquidity	2
Other	6.5

The extent to which conflicts are constructive rather than destructive depends in large measure on the processes adopted to resolve them. Our survey disclosed that respondent firms possessed a range of conflict-resolution processes, although nearly a third of them lacked formal mechanisms of any kind for resolving intra-family conflicts (see Figure 4).

Figure 4: Mechanisms used to resolve family business conflicts.

	% 2011
No formal mechanisms	31.5
Board of directors	16
Family council	16
Shareholders agreement	8
Third-party mediation	8
Formal performance appraisals	6.5
Family constitution	5
Entry and exit criteria/provisions	1.5
Other	7.5

Many business-related family conflicts are resolved informally, often by the intervention and counsel of a respected senior family member. That family member is often the founder of the business. The founder's influence often persists well past formal retirement. Indeed the founder's approval may often be sought before the current management makes decisions of any strategic importance.

Insight: The problem with informal approaches to family dispute resolution is that some affected family members may not feel themselves bound by any suggested outcome or course of action, leaving the matter to fester. Formal conflict resolution mechanisms of the kind listed are more likely to lead to firm decisions that are agreed by the majority and that are likely to be acted upon.

“In our family, business discussion gets very spirited. But it’s not conflict.”

“Sometimes it’s quite hard
to remove the emotion. You know each other’s faults, warts and all. Sometimes it’s hard to get past that to make a decision that’s not personal, even though what you’re trying to do is based on what’s right for the business.”

“I think there is a business capability gap out there in the business landscape of Australia, particularly in the mid-market. Family or non-family. A lot of businesses lack competent people coming up through the system. It’s exacerbated in families because, for example, there might be three kids, the oldest of whom wants to run the business, but lacks the ability while the youngest has the ability but doesn’t want to do it. That creates a problem.”

“We’ve had a family member who joined the business, but he was never going to be any good there, he didn’t have the skills or the cultural focus. So we let him go. It wasn’t a given that he could stay. It’s a tough decision, too, because it can cause conflicts within the family.”

Focus group participants

At a broader level, well managed family businesses usually have arrangements in place to manage the family/business interface. The more common of these arrangements are summarised in Figure 5.

Figure 5: Mechanisms reported for managing the family/business interface.

	% No	Yes
A family constitution[1] or code of conduct	80	20
Succession plans for the CEO	65	35
Succession plans for other senior positions held by family members	72	28
Estate plans (wills) for senior family members who have a stake in the business	24.5	75.5
Estate plans (wills) for other family members who have a stake in the business	49.5	50.5
Processes for welcoming, educating and inducting in-laws to the family business	86.5	13.5

The responses to the survey question on family-to-business mechanisms were of concern. Many family businesses were continuing to neglect quite basic measures that would improve the quality of both family and business decision making, formalise the relationship of the family to the business, allow for the prompt resolution of family/business conflicts and ensure smooth management succession. Four-out-of-five respondent businesses lacked something as basic as a family constitution, while nearly two-thirds had yet to formalise a CEO succession plan and three-quarters had no succession plans for other key managers. Experience suggests these businesses are likely to experience problems resulting from a failure to effectively plan for succession at some stage. The findings also raise questions about broader governance issues.

1 In its simplest form a family constitution seeks to document the family’s values and how they will participate in the management, income, wealth, and equity of the business.

Managing it right: a matter of governance

Governance has been described as the 'way we do things around here'. More formally, it is about the structures, frameworks, controls, accountabilities and responsibilities that together help the firm meet its strategic objectives and manage risks.

Public discussion of corporate governance focuses on the big end of town, notably public companies. Yet it is also relevant to family firms, although this relevance may not be apparent from our survey results (Figure 6).

Figure 6: Governance practices in place in the family business.

	% Yes	No
Financial performance	90	10
Operational Performance	83.5	16.5
Business Management team	82	18
Customer performance/feedback	68	32
Management & government structures	67.5	32.5
Communication practices	62.5	37.5
Performance evaluation indicators	62	38
HR performance	55.5	44.5
Informal Board or Directors / Governing Body	46.5	53.5
Formal Board or Directors / Governing Body	39	61
Formal feedback to family members about business matters	38	62
Environmental performance	36.5	63.5
Self assessment of the board of directors	34	66
Formal feedback to all shareholders about business matters	34	66
Family council	31.5	68.5
Independent review of the management team	23	77

In assessing these results, it is important to remember that many respondent businesses were relatively small — 50 percent reported annual turnover of less than $6 million. More than half had fewer than 20 employees. Obviously many of these businesses did not need — indeed could not justify — all of the governance structures required of larger organisations.

"We've got a non-family CFO and to be honest we don't know what he's doing all the time. He's got full access to the bank accounts and everything else. Occasionally we have time to look at bank statements, but if he was a dishonest type of guy, he could probably do some serious damage. We just don't know or have the experience to understand what to put in place to monitor that."

Focus group participant

"I'd like to semi retire, but it's just a matter of finding the right replacement and getting the business to a stage where I can do that."

"At our quarterly board meetings I like to be given a summary of what's happening. And I don't want a thick document; we're not a big business. I want a one-page overview from each key manager. Then we can have a discussion about what's happening, and put some meaning on the figures."

Focus group participants

Nevertheless it is concerning that more than half of all the surveyed firms had no board or governing body, formal or otherwise. Two-thirds did not have a family council and nearly as many failed to provide family members with formal feedback about business matters. Three-quarters lacked independent review of their management team's performance. Yet, 70 percent of respondents considered governance structures were an important element of their businesses, which perhaps suggests that the governance of family companies often reflects informal processes and arrangements that, in many instances, seem to work quite well in practice.

Does the fact that key figures in many family businesses are also family members (Figure 7) absolve these entities from the need to follow good governance practice? Does the rigour of family scrutiny match that of outsiders? Can external directors and managers add value and different perspectives to the business? We suspect many family entities are not considering these questions.

Figure 7: Family occupancy of senior management/governance positions.

Position	% Family	Non-Family	Male	Female
CEO/MD	92.5	7.5	86	14
Executive board member	83.5	16.5	62.5	37.5
Non exec-board member	53.5	46.5	64	36
Management team	54.5	45.5	62	40
Board chair	78	22	88.5	11.5

It is perhaps encouraging that significant numbers of outsiders are holding down management and non-executive board positions in Australian family companies.

We asked those who do have governance structures in place about the adequacy of their structures. Just over a third thought their existing governance structures were adequate for the needs of the business, and 48 percent thought minor or major changes could be made. We compared this to the results of the KPMG/FBA Survey of the Next Generation 2010, the results were quite different. Just 21 percent said their structures were adequate, while just over 60 percent said some change was required.

The generational gap was also evident when respondents were asked what would be the priorities of a next generation member taking over the business at the present time. Only 4 percent thought their 'next gen' successors would regard governance matters as a priority, where the 2010 Next Generation report found more than 23 percent would make governance structures their key priority (Figure 8).

Insight: Input from the 'next gen' is important to family firms that are going through the pre-transition preparation process. Input from the next gen can expose incumbent leadership to diverse views, offering leaders (usually parents) the opportunity to coordinate and balance potential conflicts in the firm's strategic decisions.

More than a third of incumbents thought their successors would be concerned with business strategy and 29 percent believed management structures would be the most pressing concern. One-in-five considered that a generational change in business leadership would result in no change in business priorities.

Figure 8: Priorities associated with the change of leadership: Incumbent expectations versus next gen plans.

%	Incumbent expectations	Next gen plans
Business strategy	36.5	37.25
Management structures	29	23.5
Cultural change	8.5	13.75
Governance structures	4	23.5
No change priorities	19.5	0
Other	2.5	2

2 Next gen figures are taken from the KPMG and FBA survey on the next generation of family business 2010.

Paying them enough: grappling with compensation and equality issues

How much should the business pay a family member? How should this stack up against what other members of the family are receiving? How does it compare with the pay of non-family employees?

"We had an in-law in the business. He left us. Part of the reason why he left us was that he didn't feel he was being adequately compensated. We had the view that we paid the position — the literature tells you to pay the position. He wasn't performing well, so he wasn't getting performance bonuses. He was angry and he left. He has since worked elsewhere and I think found that we were perhaps not as awful to work for as he had thought."

Focus group participant

These questions have been asked for as long as families have been running businesses.

Our latest survey asked companies to tell us how family members were remunerated in comparison with non-family members doing similar jobs. A quarter of firms were paying family members more than non-family employees for similar work while 61 percent said they were paying family and non-family employees the same money to perform the same job (Figure 9). Fourteen percent reported that they actually paid less to their family members. Fifty-two percent said they held higher expectations of next generation family members working in the businesses than for non-family employees.

Family members typically worked longer hours in the business than their non-family counterparts (Figure 10). Of the companies surveyed, 63 percent reported that family members worked longer.

Some family businesses have a strict policy of 'paying the position', not the individual.

Figure 9: Compensation of family members compared to equivalent non-family employees.

	% 2011
Same as non-family members	61
More than non-family members	25
Less than non-family members	14

Figure 10: Hours worked by family members compared to non-family employees.

	% 2011
More then non-family members	63
Same as non-family members	28
Less then non-family members	9

Family businesses often blend remuneration streams to include salary, dividends and access to family and business assets to compensate family members working in the business.

Any consideration of family member compensation should also take account of the fact that family members could be entitled to dividends from the business as well as other tangible benefits that might not be available to non-family employees. Family employees also usually enjoy a form of deferred compensation in that at some future point they may be able to increase

their equity in the firm, or enjoy a share of the proceeds if the business is sold or floated. So it is important to look behind nominal wage rates and salary levels when considering the equity of remuneration practices in family businesses.

Insight: Recent research has suggested that family-member CEOs were on average likely to earn less than their non-family counterparts. The researchers concluded that family CEOs accepted lower levels of compensation in return for greater job security and the social and emotional returns from working in a family enterprise.

This behaviour was also consistent with the stewardship model of family business observed in many entities. In addition, the researchers speculated that family strategic control over the family CEO might also contribute to lower than outside market levels of remuneration. Of course, family CEOs would also potentially benefit from dividend income and the other benefits of possessing an equity position in the enterprise that were noted above.

Remuneration issues can become a source of tension between family members being paid to work in the business and other members not employed in it who rely on dividends from the business, or no more than the notional increase/decrease in the value of their equity. Non employed family can decide they are being disadvantaged because employed family members are being paid too much, receiving excessively high performance bonuses, getting excessively generous fringe benefits, or enjoying significant tax breaks.

This would in turn reduce the company's taxable income and the amount that can be distributed in dividends or reinvested in the business, potentially financially disadvantaging non-employed family members. Such complaints can cause deep conflicts within a family. A desire to avoid these conflicts could result in family members being paid less than might otherwise be the case.

Our focus group discussions confirmed that difficulties of this kind can increase exponentially as the family business grows and the number of family owners/ beneficiaries is multiplied and diluted across generations.

These matters often get out of hand because the issues have not been properly thought out in advance and the appropriate structures and processes put in place. They are the kind of circumstances in which family constitutions and family councils can provide a framework for dealing with the matters in contention. Independent/outside views on positions, performance and remuneration can also help to provide transparency of remuneration practices within the family.

"We're paid according to the relevant VECCI rates. We're living comfortably and we enjoy what we do, so we're not pushing those boundaries. We're not paid any more or any less than any other employee in the business."

Focus group participant

Gaining an edge: entrepreneurship and innovation

Are family businesses more entrepreneurial and innovative than their non-family counterparts? Or does typical family business conservatism actually deter risk taking?

"The entrepreneurship of our business is tied up in Dad. He's still the driver of product and process innovation. It's critical to our success and also the biggest risk our business has. We are very much trying to break out of that mould, although some members of the family think that we need to sit still and protect what we've got. But for us to grow and be a truly great business we need to take more risks because we've got the capability to leverage that risk."

Focus group participant

Innovation in a family business is necessary to compete and grow against better resourced and often publicly owned businesses. In this context, innovation means doing things better, faster and cheaper, in order to succeed with limited resources.

It is difficult to ascertain whether there is any meaningful relationship between the qualities associated with successful family enterprises and levels of business entrepreneurship and innovation. However, for our latest survey we did ask family firms about their attitudes to innovation. The replies are summarised in Figure 11. The notion that innovation was a good thing received overwhelming support from our survey respondents. But perhaps tellingly, only a minority of respondents had actually set aside funds for innovation and R&D.

Figure 11: Family business attitudes to innovation.

	% Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Innovation is a priority for our business	32.5	46	18	2.5	1
We have nurtured a culture of innovation within our business	20	51	23	4.5	1.5
Funds are set aside for innovation/research and development activities	9.5	28	40	15.5	7
Innovation is a key to our success	20.5	43	27.5	7	2

Twenty percent of respondents also felt it was 'critical' that their successors exhibited entrepreneurial flair while 55 percent claimed it was a 'very important' succession consideration. Our survey showed a positive statistical link between attitudes to innovation and feelings about entrepreneurial successors. That is probably no surprise.

It became clear from our discussion groups that most family businesses valued their flexibility and adaptability, and regarded these qualities as important aspects of entrepreneurship and innovation. It was less certain that these qualities of flexibility and adaptability were translating into actual entrepreneurial behaviour and innovation.

"We're looking at innovation around products and markets as opposed to financially taking risks."

"My experience is that for the third and fourth generation innovation becomes more and more critical because you have to regenerate something to keep it going."

"I don't think innovation necessarily needs money — innovation requires brain power. You don't need to outlay big dollars to be innovative."

Focus group participants

Of course, there could be a generational factor at work here. Founders will have likely possessed a degree of entrepreneurial flair in order to have created and grown a successful business, taking risks out of necessity. The next generation is more likely to revitalise the business strategy and professionalise how the business is run, than pursue a risky or entrepreneurial agenda.

While entrepreneurship literature generally focuses on the creation of new enterprises, especially through new ventures, innovation and renewal within organisations, family firms do not face just one of these challenges. Rather, they need to find ways to create new streams of value within an existing long-term oriented organisational setting, through exploration of new ways of doing things and at the same time through exploitation of existing products, service or organisational processes.

Insight: A study of innovative strategy and environmental uncertainty associated with technological change found that family firms manage and adjust to change in the external environment quickly. While such notions are more associated with high-tech firms, they found that family firms exhibit similar relationships and behaviours.

The longitudinal nature of the study confirms that family firms not only select postures based upon environment and innovative strategy, but that they adapt such postures over time. This demonstrated that linkages between established family firms and innovation are substantially stronger than assumed by many.

"I'd argue that as family businesses we don't adapt and respond quickly enough. During the downturn we saw what had to be done, but we slow to do anything about it."

"The positive side of family business is the ability to change and adapt quickly. We are very conscious of not getting to a size where our ability to change and adapt is stifled."

Focus group participants

Taking the ultimate step: preparing to sell the family business

Most businesses eventually pass from family ownership and control. How this happens is vitally important to the families concerned.

"Nothing is ever not for sale. If you have someone come along with an extremely attractive offer, anything is possible. But we see ourselves more as caretakers for the next generation. That's our goal."

"It comes back to that notion of the family business versus the business family. I think the business family is a far more flexible concept. The family isn't necessarily locked into the changing fortunes of a single business."

Focus group participants

As the so-called '*baby boomer*' generation heads for the beach and the golf course, there should be a sharp increase in the number of family businesses being handed on to the next generation, or simply being put up for sale.

When we used our survey to ask respondents if their businesses were exit or succession ready, just over a third said yes. Coincidentally, exactly the same proportion reported that they had been approached to sell their business during the previous 12 months. Interestingly, 59 percent said they would consider selling the family business if approached by a genuine buyer. Going by the responses to the first question, quite a few respondents could be prepared to sell their businesses even though their businesses are less than fully fit for sale.

We thus asked focus group participants to give their perspective on these results and asked them to more broadly define their criteria for sale. A distinction between the economic pragmatists and the emotionally attached arose and two very different perspectives surfaced.

Those emotionally bound were committed to building and passing a business on to the next generation because they felt that there was intrinsic value in family ownership, beyond that of money on the table.

The pragmatists were more definitive in separating the family from business and explained that for some, the sale of a business does not necessarily mean the end. One participant commented that "there is a subtle but important distinction between family business and family wealth. Businesses come and go." While another suggested that your business is "never not for sale, it's always good to know what you're worth".

Thus, where some will focus on the transfer of ownership from one generation to the next, others will shift their focus to the development of entrepreneurial mindsets and capabilities, sometimes across generations which can be deployed into new activities and businesses.

Insight: Bond University research has termed this 'transgenerational entrepreneurship' – a reference to how families create new streams of value across generations – not simply how to grow and pass on a business.

We then asked owners about possible exit strategies for their businesses. The responses are tabulated in Figure 12.

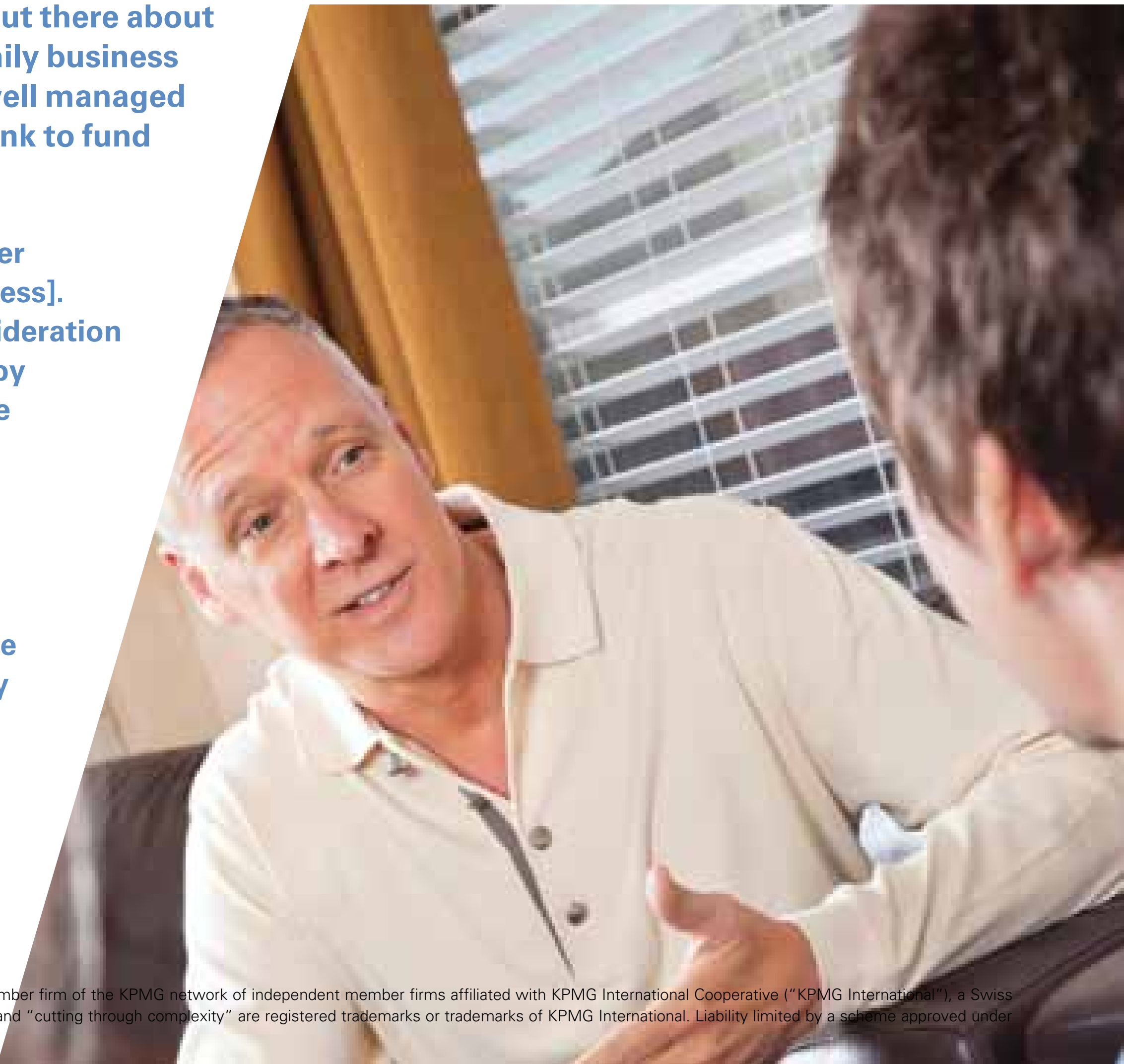
Figure 12: Consideration of exit strategies in the short, medium and long terms.

%	Short term (12 months)	Medium Term (3 years)	Long term (5+ years)
Sale of business to a competitor/trade sale. Independent third party	50.5	42	33.5
Passing the business to the next generation	12.5	17	23.5
Appointment of a non-family CEO	12	11.5	10
Sale to a private equity consortium	9	8.5	7.5
Sale to current employees	7.5	8.5	10
Venture capital	3	4.5	4
Sale to another family member	3	5.5	6
Initial public offering	2.5	2	5
Other	0	0.5	0.5

"There's a lot of myth out there about banks not funding family business succession. If you're well managed you won't need the bank to fund your succession."

"We had to assess an offer [to buy the family business]. Unfortunately our consideration of it was largely driven by emotion. So you had the economic pragmatists on one side, who were in the minority, and the majority family view on the other. The majority view dominated, and the offer was never properly considered."

Focus group participants



Across all three timeframes, a moderate number of respondents intended passing their business on to the next generation, a prospect twice as likely in the long-term. Some form of sale of the business outside of the family was the overwhelmingly preferred exit strategy and the implementation of any exit strategy was also three times more likely in the long term (5+ years) at 55 percent, than in the short term (12 months) at 16 percent.

We then asked participants whether their business possesses sufficient resources to divide its assets fairly between all heirs and beneficiaries. Three-quarters of respondents answered yes to this question. Of course, dividing business assets fairly is not the same thing as possessing sufficient resources to satisfy everyone's financial needs and expectations.

Overall, it was encouraging that even many third, fourth and fifth generation businesses believed they possessed sufficient resources to divide up equitably between all beneficiaries, even allowing for an increasing number of beneficiaries as the businesses concerned became older. The relative financial health of many long-lived family firms probably results from a combination of patient capital, conservative dividend distributions, a long-term business orientation, restrained financial leverage and solicitous stewardship.

Decisions about exit strategies will reflect a range of considerations. For example, the principals of many family businesses want to realise their equity in the enterprise, often to fund their retirement. Trade sales are often the most effective way of attaining this objective. Children and other family members might be able to buy out the incumbent owners, but perhaps only by taking on significant debt burdens. Tax considerations can also shape exit strategies.

Business exit strategies that best meet the needs and aspirations of all family stakeholders are likely to be the result of family consultation, clarity of purpose and careful planning. Good strategies are likely to embody sufficient flexibility, allowing families to promptly and decisively take advantage of favourable but transient circumstances. As we know, in business timing can be critical.

"Have the debate about the future of the business before someone puts dollars on the table."

"So many businesses for sale are just run down and the owner wants to get out. Very few are prepared, or have a realistic idea of what other people perceive the value of the business to be. We all like to think our business is worth far more than what it is really worth."

"It takes 2 to 3 years to prepare your business for sale."

"Each generation should start again. Don't create these monstrous, multi-generational companies."

Focus group participants

Letting go and handing over: when the time to leave finally arrives

For many family business owners, handing over to the next generation seems to be in the natural order of things. In truth, the succession process can be difficult, complex and uncertain. Be clear about what succession is meant to accomplish.

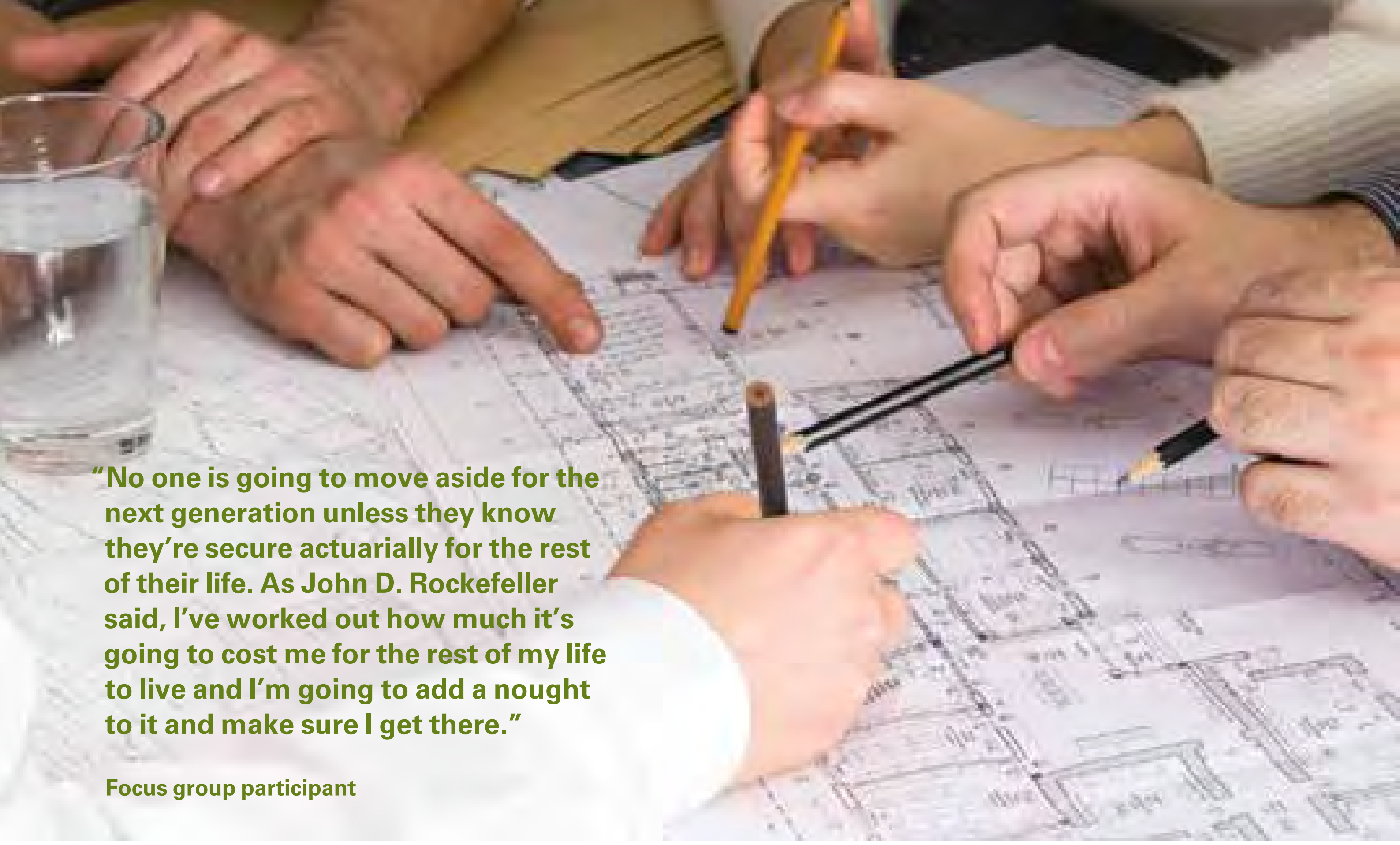
As we have already noted, only a fairly moderate number of respondents planned to hand on their businesses to the next generation (Figure 12). Those who have committed to go down this path will in due course discover how difficult the succession process can be. To gain more insight into the issue, we asked respondents to rank a range of matters in terms of their likely effect on the succession process, both within and outside the family. Figure 13 summarises the results.

Figure 13: Issues affecting the succession process.

%	High positive	Somewhat positive	Neutral	Somewhat negative	High negative
The ability to generate adequate financial returns	33	40.5	14	9	3.5
The financial capacity to retire	33.5	29	24	5	5
Level of trust in the abilities of the potential successor	29	33	26.5	6.5	5
Level of interest of potential successors in the business	32	28.5	28	6.5	5
The motives of potential successors	26	29.5	36	3.5	5
My willingness to let go	20.5	27	33	12.5	7
Fair valuation of the business	10	20	55	9.5	5.5
Concerns about my retirement plans	10.5	22.5	49	11	7
Willingness of financiers to support succession/retirement	10.5	22	50	9.5	8
Legal requirements of the succession process	10	20	55	9.5	5.5
Capital Gains Tax implications	11	17	47.5	16	8.5
Concerns about fairness of ongoing succession arrangements	8.5	18.5	56.5	9.5	7
Lifespan of family trust structures	8	15.5	59	8	9.5
The impact of the downturn	5	11	55	17	12

The big four succession issues covered:

- the ability to generate adequate financial returns
- financial capacity to retire
- trust in the abilities of the potential successor
- potential successors' interest in the business.



"No one is going to move aside for the next generation unless they know they're secure actuarially for the rest of their life. As John D. Rockefeller said, I've worked out how much it's going to cost me for the rest of my life to live and I'm going to add a nought to it and make sure I get there."

Focus group participant

Insight: Peace of mind about the financial capacity to retire can be secured by implementing a strategy for sustainable business performance. By enabling incumbents to build wealth outside of the business, the next generation can more likely afford to buy, sustain and grow the business.

Our discussion groups generally confirmed these concerns, adding additional context and detail to many of them. In particular, participants felt the willingness and ability of incumbent owners and managers to actually let go of the business and hand it over to a successor could be a considerable problem. For those who were doing the handing over, there were concerns about the future of business and the capabilities and qualities of those taking over the helm. We also asked survey respondents to rank the attributes of their potential successors according to their importance (Figure 14).

"I've been more fortunate than many. In my discussions with my daughters and the board, the girls have always turned around and said 'our greatest concern is mum and dad's financial security', not 'what's in it for me?' It's relieved a lot of pressure that they can see it in that light."

Focus group participant

Figure 14: Attributes of importance in a potential successor.

%	Very important	Moderately important	Not important
Experience from outside the business	48	39.5	12.5
Experience working inside the business	67	26.5	6.5
Understanding of the principles of finance/ investment mngt	69	26.5	4.5
A desire to work in the business	91	8.5	0.5
Independent assessment of leadership potential	41	41.5	17.5
Level of commitment to the business	92	7.5	0.5
Attainment of formal business qualifications	34	46	20
Other	70.5	22	7.5

"It's not about a successor, it's about the succession process."

"I'm asked when I'm going to let go. Well, I'm not going to let go, not until you have a good grip on the baton and are running with it. Even then I might not let go because you might drop it. This business you're talking about is my baby. I created it and it's the wealth of this family and the security of this family going forward. I'm not just going to hand it over and walk away and let you destroy it, or let you run off and do your own thing and forget everything you've been told."

"My daughter wanted me to become 'brand ambassador'. She had a plaque made. I said I don't need a plaque, I've been doing this since the day I started the business. To be honest, my aim is to get out of the business, not to be given another job in it because what ends up happening is I fill in for everyone else."

Focus group participants

A commitment to the business and a desire to work in it were the most prized attributes, ranking well ahead of concerns such as the existence of formal business qualifications and outside experience.

Taken together, these results suggested that many owners possessed a strong ongoing sense of stewardship when it came to the business. This sense of stewardship did not disappear simply because a decision had been taken to sell the business, or hand it over to a family successor. These motivations could also be tied up with the owners' personal circumstances and the often ambiguous nature of relationships with children and other family members.

Insight: Succession planning can involve juggling personal financial considerations, retaining family harmony, reconciling the ambitions and expectations of particular family members, and safeguarding the future of the business.

As one focus group participant summarised succinctly, "the pressure to get the succession decision right is huge. It's part of our psyche that the succession candidate has to be right. You can't afford to get it wrong. Grooming for succession is a very difficult task and it's a challenge to get it right."

Given the potential complexities, it was hardly surprising that many survey respondents appeared to have avoided formulating succession plans (Figure 15).

Figure 15: Formal succession plans for management, control and ownership

	% Yes	In process	No
Management	26	30.5	43.5
Control	23.5	28	48.5
Ownership	28.5	25.5	46

Succession plans, when they existed, were rarely well articulated. Thus 77 percent of survey respondents reported having changed their succession plans over the previous 12 months. These changes involved different exit options (26.5 percent), different exit timing (46.5 percent) and the abandonment of existing exit plans (9.5 percent).

"I decided to step aside when I realised I had limited time left to spend with my own parents. So I turned around to my daughter and said you've got six weeks to learn my role completely because I'm stepping out and handing over. I had a huge party for all the staff and introduced them to their new boss and told them to no longer come to me. I occasionally came into the office and backed her up. As it turned out it was a smooth transition because she had spent 18 years working alongside me. It occurred to me that only Prince Charles had served a longer apprenticeship."

"My father is 82. He comes in every Thursday. That's ownership!"

"People say to me you can play golf, but I HATE golf."

"I need to retire, that is a fact. But if I'm not that business, who am I?"

Focus group participants

About the survey

The KPMG/Family Business Australia survey was conducted during April and May 2011. Participants were the incumbent generation of 658 family businesses located across all states of Australia. Businesses were drawn from all industries and a broad cross section of the economy.

Industry representation in 2011 family business survey.

	% 2011
Accommodation, cafes and restaurants	2.5
Agriculture, forestry, fishing and hunting	8.5
Business and consulting services	1.5
Construction	12.5
Cultural and recreational services	0.5
Education	0.5
Electricity, gas and water supply	0.5
Finance and insurance	2
Health and community services	1
Information technology	1
Manufacturing	21
Media and entertainment	1.5
Mining	0.5
Personal and other services	1
Property services	5.5
Retail trade	12
Telecommunications	1
Transport and storage	7
Wholesale trade	12.5
Other	7.5

Business size based on annual turnover.

	% 2011
Less than $500 thousand	2
Between $500 thousand and $1 million	5
Between $1 million and $5 million	43
Between $6 million and $10 million	19.5
Between $11 million and $20 million	13
Between $21 million and $50 million	7.5
Between $51 million and $100 million	4.5
Between $101 million and $200 million	3.5
$200 million +	2

Business size based on employment numbers (full time employees).

	% 2011
0 – 10	25.5
11 – 20	25
21 – 50	25
51 – 100	11.5
101 – 200	5
201 – 300	2
301+	6

Age of business.

	% 2011
Less than 2 years	0
2 – 5 years	3
6 – 10 years	8
11 – 15 years	11
16 – 20 years	11
21+ years	67

Contact us

For further information about this survey or to find out how KPMG can help your family business, please contact:

Adelaide
Laurie Madigan
+61 8 8236 3215
lmadigan@kpmg.com.au

Brisbane
Bill Noye
+61 7 3233 3253
wnoye@kpmg.com.au

Cairns
Doug King
+61 7 4046 8888
dougking@kpmg.com.au

Darwin
Denys Stedman
+61 8 8982 9000
dstedman@kpmg.com.au

Gold Coast
David van Herwaarde
+61 7 5577 7545
dvanherwaard@kpmg.com.au

Hobart
Matthew Wallace
+61 3 6230 4037
mgwallace@kpmg.com.au

Launceston
Nigel Briggs
+61 3 6337 3711
nbriggs@kpmg.com.au

Melbourne
Dominic Pelligana
+61 3 9288 6386
dpelligana@kpmg.com.au

Perth
Matthew Beevers
+61 8 9263 7228
mbeevers@kpmg.com.au

Sydney
Stephen Maze
+61 2 9335 7822
smaze@kpmg.com.au

Sunshine Coast
Bruce Swan
+61 7 5444 7999
bswan@kpmg.com.au

Wollongong
Peter Fitzgerald
+61 2 4231 5370
pfitzgerald@kpmg.com.au

For further information about Family Business Australia, please contact:

Free call 1800 249 357
info@fambiz.org.au
National Office

Level 3, 450 St Kilda Road
Melbourne, VIC, 3004

Or please visit www.fambiz.org.au

For further information about Bond University's
Australian Centre for Family Business, please contact:

Dr Justin Craig, Associate Professor
+61 7 5595 1161
jcraig@bond.edu.au

Professor Ken Moores AM
+61 7 5595 2088
kmoores@bond.edu.au

Family Business Australia

Australian Centre for Family Business