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Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
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Australia

Family Business Australia Submission to the Inquiry into family business

Terms of Reference

1. the definition of 'family business'
2. the availability and reliability of information and statistics about family business in Australia
3. the contribution of family business to the Australian economy, in terms of financial, social, employment, innovation and sustainability outcomes
4. structural, cultural, organisational, technological, geographical and governance challenges facing family business
5. the role of family trusts in facilitating family business;
6. access to and the cost of finance and insurance for family business;
7. family business responses to the challenges of the GFC and post GFC resilience

Introduction

Family Business Australia (FBA) is a national, member-based, not-for-profit organisation for family business owners and operators and their professional advisers. FBA recognises that family businesses have unique characteristics and make a significant contribution to the life, culture and economy of Australia. Accordingly, FBA's objectives are to:

- Improve the effectiveness of Australian families in business through the sharing of practical experience and knowledge;
- Promote the value and contribution that family businesses make to our society; and
- Represent Australian family businesses as a strong and united voice.

It meets these objectives in various ways through its national education programs as well as state based programs run by the local FBA chapters. These include facilitated forum discussions, panel presentations, conferences and courses developed under the auspices of various academic institutions.

Of particular importance is FBA's focus on enhancing the contribution of its constituency to the Australian economy by providing educational offerings aimed at optimising the family business sector's performance and ensuring longevity.

FBA has developed, in conjunction with the Australian Centre for Family Business (Bond University) a suite of six one and two day courses. These are: Family Business Directors Course, Family Business Leadership Course (aimed at the Next Generation of leaders and prospective owners), Family Business Succession Planning Course (focusing on leadership transition), Family Business Strategic Planning Course, Financial Essentials for Family

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Business (developed with KPMG, Middle Markets), and finally, for advisers to family firms, Fundamentals of Family Business Advising (developed by Mac Hay, Melbourne Business School).

Significance of the sector

Family owned businesses comprise about 67% of businesses in Australia and they employ more than half of the Australian workforce (MGI Australian Family & Private Business Survey 2006). This means they make a very significant contribution to the Australian economy and society in general.

Family businesses are often mistakenly referred to as small businesses when in fact they range from very small businesses to very large enterprises, such as Visy and Linfox.

Academics and professional practitioners have only recently (within the last 25 years) recognised the uniqueness and importance of that sector of enterprises owned and controlled by families (or small groups of families) and their work continues to explore and communicate the way in which the three important overlapping sub-systems of family enterprise – the ownership, family and business subsystems – can most effectively co-exist for their mutual benefit and to ensure productivity for both local and national economies.

Addressing the Terms of Reference

1. The definition of 'family business'

There is no universally agreed definition of a family business although there is general agreement that the involvement of 'family' in a business has both challenges and opportunities that are of importance to society and economies. For the purposes of identification, FBA uses an inclusive definition: *'a family business is comprised of two or more members of the same family involved in the business with one or more related members having a controlling interest.'* Another useful definition of family business is one which recognises the potential for the business to be passed to the next generation of the family, thus emphasising the long term continuity of the family business which has been demonstrated to be a competitive advantage: *"A family business is a business in which related family members control the ownership, vision and direction and which is potentially sustainable across generations of the family"* (adapted from Lansberg, Perrow, Rogolsky, 1988).

For the information of the Inquiry, two approaches to defining family enterprises and distinguishing them from other organisational forms have been used in the literature: the *components of involvement* approach and the *essence* approach. While the *components* approach captures the nature and extent of family involvement in business, including factors such as number of generations of ownership, family and non family managed, percentage of ownership held by a family group; the *essence* approach focuses on family aspirations as well as family involvement, since it is both aspects that lead to behavioural and performance consequences for the firm (see Chua et al, 1999 and Sharma et al, 2012).

Recommendation: That the Inquiry adopt an inclusive definition of family business as follows:

'a family business is comprised of two or more members of the same family involved in the business with one or more related members having a controlling interest.'

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2. The availability and reliability of information and statistics about family business in Australia

FBA has commissioned five annual surveys of the family business sector, sponsored by KPMG and undertaken initially by Deakin University and subsequently by the Australian Centre for Family Business. Three additional surveys have been undertaken by academics at RMIT, sponsored by MGI. Each of these surveys has explored themes important to an informed understanding of the Australian family and private business sector; however the reliability of the data in each case is limited by their relatively small sample size.

In their study of publicly listed family owned businesses from the Standard and Poors U.S. 500 database, Anderson and Reeb (2003) found that family ownership is an effective organisational structure and that family firms (both young and old) perform better, and are more valuable than non-family firms. Several studies confirm this conclusion.

In light of their purported importance to the Australian economy, we firstly need to ascertain certain fundamental information about the sector (similar to the 'components' of the family business mentioned above; eg how many there are, financial data, governance mechanisms, employee numbers, etc.). Rather than relying on 'best estimates', specific data about the family business sector needs to be documented in a consistent and ongoing manner. Research is required to properly analyse the data to better understand how family businesses operate, how decisions are made and what policies and practices will help enhance their contribution to the economy.

As the majority of the family businesses are unlisted private companies we believe appropriate survey questions asked of a wide sample of businesses will provide reliable information about the size and composition of 'the family business sector' and include information about how and by whom they are governed, run and owned. We anticipate that a survey instrument which profiles 'family businesses' will enable the extraction of other data selected for those business types to characterise their performance in terms of productivity, employment patterns and so forth.

We will then be in a position to compare Australian data with that collected in other developed economies where family business is specifically recognised as an important, discrete business form for which specific policy has been formulated to benefit those local and national economies. Australian governments have thus far failed to recognise and appreciate the importance of the family business sector, let alone introduce innovative policy designed to leverage the vast patient capital invested by Australian family businesses – estimated in 2006 to be more than three times the market capitalisation of the ASX (MGI Australian Family & Private Business Survey 2006).

Past communication in August 2009 with Ms Helen Harkin of the Australian Bureau of Statistics ('ABS') elicited the following: "One of the key aims of the BLD [business longitudinal database] is to enable analysis of productivity growth generated by business, including the capacity of business to undertake activities which lead to productivity growth and the relative importance of these activities in driving that growth." Relevant to this aim; there is clear global evidence that family businesses outperform their non-family counterparts, thereby casting some doubt on the ABS view that: "given the wide variation in business structure and management style within family businesses, it was unclear how being a "family" business or otherwise had a direct relationship to business productivity." (Harkin, 2009 Personal Communication)

We support the stated aim of the BLD, but as intimated in the previous sentence, research carried out internationally and in Australia suggests that family businesses have unique characteristics which have economic implications such that a better understanding of the Australian context – and within it, "the wide variation in business structure and management style within family businesses" – could inform government policy-making and other initiatives designed to enhance the country's economic and social development.

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Recommendation: That the Parliamentary Joint Committee on Corporations and Financial Services recommends the Australian Bureau of Statistics collect data that will elucidate the nature of the family business sector in Australia. To do so, it might ask questions (in respect of a business) which FBA and its academic associates have developed, and would be able to provide.

3 . The contribution of family business to the Australian economy, in terms of financial, social, employment, innovation and sustainability outcomes.

Financial

The MGI Australian Family & Private Business Survey 2006 found that:

- The estimated wealth of Australian family firms is \$4.3 trillion;
- Their average turnover is \$12 million;
- The average tenure of an Australian family business CEO is 17 years – leading to continuity of vision and stability
- In 2006 the average percentage growth in sales (over the previous three years) was 16;
- The average percentage growth in net profit before tax as a proportion of sales (over previous three years) was 12.
- The average age of firms surveyed in 2006 was 28 years and the average number of employees was 39.

Employment

Family businesses play an important role in creating employment, generating innovative technology, and improving our quality of life. These companies are also essential for incubating and financing new businesses. Astrachan, Zahra, and Sharma (2003), using data from multiple countries, conclude that family businesses are a key source of funding for new startups that create employment and promote economic and technological progress.

The MGI Australian Family & Private Business Survey 2006 found that 67 percent of all businesses in Australia are family owned, employing an average of 39 employees, statistics on the average tenure of employees in family firms is non-existent, however, the average tenure of a family business CEO is 17 years.

Social

Whilst well know philanthropists such as the Myer, Pratt, Murdochs, Gandel and Packers are often applauded in the media, there is a lesser known family business community in Australia that has generously supported Australian society through a range of giving means including financial and in-kind support. Philanthropy Australia notes on its website around a hundred private and family foundations – most of which developed from family businesses. In FBA's experience, most of our family business members contribute significantly and generously to their local community in a multitude of ways thus enriching the very fabric of Australian society.

4. structural, cultural, organisational, technological, geographical and governance challenges facing family business

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Legal structure

A 2011 KPMG study found that family businesses favour a company structure (73%) followed by family trusts (18.8%), unit trusts (6%) and partnerships (2.6%). Most family companies preclude the general public from ownership and limit trust membership to prescribed parties. This is typically achieved through (business) constitutional provisions which limit the scope of share issues or transfers to parties related to the incumbent owners, or selected by them. Such entities are described as private companies.

Ownership structure

The MGI Australian Family & Private Business Survey 2006 found that for those owners who consider their enterprises to be family firms, 80% are 100% owned by related family members; 11% indicate that between 50% and 100% of ownership is through related family members; 7.3% through a group consisting of more than one (?unrelated) families and 1.7% report that the family has control or provides management to the business.

In 2007, this same Parliamentary Joint Committee on Corporations and Financial Services enquired into shareholder engagement and participation. Specific representation was made by FBA in respect of the “50 shareholder rule” (section 113 of the Corporations Act 2001). FBA reiterates its objection to this provision, in respect of which anecdotal evidence indicates that increasing numbers of family businesses which are aware of the consequences of ownership by more than 50 shareholders adopt a range of shareholding arrangements to keep their share register below 50 non-employed owners. Examples of such strategies include: minimum shareholding limits and otherwise independent shareholdings being held jointly under various ownership, or beneficial ownership structures.

It is understood that the ‘50 shareholder rule’ – which requires a proprietary company with more than 50 non-employed shareholders to become a (unlisted) public company – is intended to protect the interests of those ‘passive’ shareholders. It not only unnecessarily duplicates other forms of legislative protection provided to such stakeholders, but represents a simplistic approach to that objective which adds considerable cost with, in most cases, little or no benefit to those it is designed to protect.

FBA espouses alternate family business governance structures and mechanisms which more proactively support the principles of democracy, effective employment of family capital and continuity, which, we respectfully submit, more effectively support the national objective of sustained (and sustainable) economic growth, whilst protecting – even empowering – minorities.

Many have some shareholders not working in the company, which is assumed to exclude most small family firms. Paradoxically, it may also exclude some very large enterprises.

Despite a recommendation by this Committee to lift the ‘50 shareholder rule’ to 100, this has never been enacted.

Recommendation: That the 2008 Parliamentary Joint Committee on Corporations and Financial Services recommendation on the “50 shareholder rule” (section 113 of the Corporations Act 2001) be enacted to lift the shareholder threshold to 100.

Cultural challenges

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Some of the cultural strengths that make a family business successful can also act as obstacles to change, if not recognised and appropriately managed. We need more research on behaviours of key managers and owners and the implications of their actions for longevity, performance and productivity.

One strength is the longer tenure of CEOs and other senior leaders; however, if they do not 'let go' in a timely and appropriate manner this can become a weakness. The leader's tenure in a non-family company is, on average, six or seven years, while the leader of a family firm may run the business for an entire generation. Mature firms with long-tenured key executives understand the cycles in their industry, and have learned to manage downturns for the benefit of owners with a patient orientation to the performance of their capital.

Family Business Australia, in conjunction with the Australian Centre for Family Business at Bond University has developed a Leadership Course aimed at fostering the next generation of family business leaders to ensure successful succession and continuity of the business sector. Our Succession Planning Course also supports the concept of ensuring an organised transition of leadership of the family business which in turn promotes stability and continuity of the business.

One of the major challenges for families in business is to find the balance that enables them to manage their businesses effectively without creating family conflict. Owners are often asked the question: *does the family or the business take precedence in the family's value system?*

Aronoff and Ward (1995) contend that family businesses tend to be smaller and more entrepreneurial than most public companies. Hence they have the ability to move quickly, with less bureaucracy and fewer decision makers.

Owners have more influence on company culture when the owner and the family openly discuss and document their values through a governance process such as developing a family culture. This introduces to subsequent generations the cultural values on which the business is founded. The benefit of reinforcing such values is an ability to create a shared purpose and vision amongst the shareholders of the family to ensure continuity for generations to come.

Traditions however, while a source of strength for a family and its business, can have a downside. When they are observed to the exclusion of all else, without thought given to their relevance for the present, traditions can limit the strategic development of the company.

FBA educates family firms to understand that tradition means 'we do it this way because we've always done it this way', while values mean 'we do it this way because it expresses our beliefs, reflects who we are and contributes to the meaning of our lives'. FBA therefore educates family businesses to consider their responsibilities to renew and revitalise the business as the context in which they operate changes and evolves.

Governance challenges

One of the world's leading family business educators, Professor John L. Ward suggests that for the rapidly growing family business, an active Board of Directors can serve a number of functions, including assisting owners to deal with feelings of isolation in their daily struggle to survive and excel, heightening accountability of the business, improving the quality of corporate decision making and planning – without significant loss of privacy.

In 2010 FBA commissioned the Australian Centre for Family Business at Bond University to develop and present a bespoke Family Business Directors Course (FBDC) to address the specific complexities of family business governance. This is an area often overlooked by the family business sector, to their detriment.

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This course provides relevant stakeholders with a practical insight to the governance issues specific to families in business; to the effective governance of the business itself and the interaction of the two, together with the vital ownership system. The course enables families to manage themselves in various roles relative to their business with the multiple benefits of enhanced familial harmony and most importantly, a professional orientation towards the productive management of family wealth, both within and beyond the business system. The economic benefit of adopting such a system of governance is, fundamentally, twofold: enhanced productivity through more enlightened operation of the business and mitigation of the economic loss and emotional cost caused by family disharmony, principally due to poor communication.

Members of FBA's network have derived tangible benefit from the FBDC; however, that network is relatively small when considered in the context of the national family business community. Were family businesses nationally to receive such education, the economic and social benefit to the nation would be substantial. FBA would appreciate the opportunity to explain its family business governance initiative to relevant government personnel with a view to expanding its outreach of the courses.

A 2006 survey undertaken by Deakin University for FBA and KPMG found that 61 percent of family owned businesses would face transition in the next 10 years, yet 78 percent had no formal succession plan.

FBA has responded with the development of the first comprehensive Succession Planning Course, designed to address both transactional challenges and the important emotional challenges of 'handing over', whether it's a family (inter-generational transfer) non-family (external CEO) or sale.

Recommendation: That government agencies refer family business operators to programs addressing governance issues in family businesses, including the Family Business Directors Course, Succession Planning Course, Next Generation Leadership Course developed by FBA, to ensure family owned enterprises have access to the tools and frameworks to ensure a successful succession and long term sustainability. These courses could provide to support to family businesses. General business support for small businesses via Business Enterprise Centres and Regional Development Boards is already available – family business specific education would be a much needed addition .

5. the role of family trusts in facilitating family business

The use of trusts, particularly discretionary trusts, plays an integral part in any family or privately held group structure. In essence, any family unit is best described as a 'socialist' system where all members are encouraged to be inclusive and treat one another fairly. Family trusts assist this system as they facilitate the following:

a. Asset protection

Given the risks associated with any commercial enterprise, trusts are often used to separate passive assets from business risks; for example the risk of owning a warehouse is very different to the risk of owning and operating a distribution business, therefore most professionally managed family and privately owned businesses would own the warehouse in a trust for the benefit of their family and have the business owned and operated by another separate entity.

Similarly, as assets are accumulated by families in business, they seek to protect and grow these assets for subsequent generations. Family/discretionary trusts enable assets to be held so that successive generations can act as stewards and custodians.

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As a natural extension of managing risks associated with commercial enterprises, Directors, of family, private or public companies, use trusts to protect their passive assets from frivolous and litigious creditors.

b. Facilitate the intergenerational transfer of Control and Ownership

The challenges facing family owned enterprises around the succession of control and ownership are well documented. Family/discretionary trusts allow control to be transitioned over time from one generation to the next without the need to actually have to fund the physical transfer of assets and associated and unnecessary tax liabilities arising from these transactions. These savings, of transaction costs and taxes, can then be used to continually grow and diversify assets and continuing the family business's strong economic contribution to society.

c. Estate planning

As an extension the benefits associated with asset protection and facilitating intergenerational transfers, trusts are used extensively in estate planning where assets can be left for the benefit of family members for generations to come protected from outside creditors and property settlements associated with divorce.

d. Tax efficiency

The creation and growth of most family and privately owned businesses are funded by retained earnings and debt. Trusts can provide tax planning opportunities to ensure that the retention of funds are maximised to facilitate growth.

Recent changes, particularly the measures around *Unpaid Present Entitlements owing by Trusts to Private Companies* after 16 December 2009 are now unnecessarily complicating family and privately owned business models causing additional compliance and transaction costs at a time when the entire economy is facing challenges.

Recommendation: That the Inquiry recommends to the Federal Government removal of measures around *Unpaid Present Entitlements owing by Trusts to Private Companies* after 16 December 2009.

6. access to and the cost of finance and insurance for family business;

Sources of Funding

Irrespective of generation of ownership, family business owners are most favourably disposed towards the use of cash flow and retained profits as sources of capital. For first and second generation businesses these sources are followed by bank overdraft, shareholders' funds, and bank loans. Third to fifth generation forms appear to place greater reliance on shareholders' funds and family loans, but less on leasing finance than their first or second generation counterparts.

Equity finance is the least favoured source of capital, and fewer family proprietors are prepared to consider offering part of the ownership of their business to secure funding for growth.

The potential benefit of FBA's FBDC has been outlined above. More specifically, it (and other FBA educational initiatives) is also relevant to finance and insurance in a family business context. The FBA approach to family business governance includes the important elements of educating the family not only as an effective social system, but as an informed investor body. Its governance structure will typically include independent directors with broad industry and general business knowledge, experience and contacts. This network, combined with appropriate family and business constitutional arrangements can enable the enterprising family in business to access patient

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private capital to help fund business growth with safety and confidence. Such professional governance systems can also provide additional confidence to positively influence a debt financier's decision-making in respect of loan funding.

Likewise, although professional risks insurers are typically cautious in the family business environment, the level of risk in a professionally governed family business may be demonstrably reduced to the point where non-insurance thresholds are lowered for the ultimate benefit of the insured.

Recommendation: That government uses its agencies to encourage family business specific education as risk mitigation.

7. family business responses to the challenges of the GFC and post GFC resilience

Mature firms with long-tenured key executives understand the cycles in their industry, and have learned to manage downturns. They typically resist short-term temptations, such as over-committing to growth in boom times, by taking a long view.

Family firms are also traditionally less highly leveraged, and therefore less likely to be susceptible to banking constraints.

Recommendation: That government uses its agencies to make FB owners aware of programs such as FBA's forum program to support FB executives at a time when isolation can often be their downfall.

In conclusion

As would be apparent from the information provided above, the family business sector is not adequately represented by a Minister for Small Business, whose portfolio extends to those businesses with a turnover of \$2 million or less, and employs 20 or fewer employees.

We respectfully request that the Parliamentary Joint Committee on Corporations and Financial Services act on the following:

- Recommend the appointment of a Minister for Family Business
- Agree to adopt an inclusive definition of family business as follows: *' a family business is comprised of two or more members of the same family involved in the business with one or more related members having a controlling interest.'*
- Recommend that the Australian Bureau of Statistics collect data that will elucidate the nature of the family business sector. To do so, it might ask questions (in respect of a business) which FBA and its academic associates have developed, and would be able to provide.
- Recommend that the 2008 Parliamentary Joint Committee on Corporations and Financial Services recommendation on the "50 shareholder rule" (section 113 of the Corporations Act 2001) be enacted to lift the shareholder threshold to 100.
- Recommend removal of measures around *Unpaid Present Entitlements owing by Trusts to Private Companies* after 16 December 2009

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- Recommend that government uses its agencies to encourage family business specific education as risk mitigation.
- Recommend that government uses its agencies to make family business owners aware of programs such as FBA's forum program to support family business executives at a time when isolation can often be their downfall
- Recognise Family Business Australia as the peak body for family business.

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