

BUSINESS SCHOOL

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The Secretary
Senate Economics References Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir/ Madam/ Ms

Inquiry into Access of Small Business to Finance

Last week, we completed a report for CPA Australia, entitled, "Understanding the Barriers to and Opportunities for Access to Private Equity for Small-to-Medium-sized Family-owned Enterprises (SMFEs)". This research was funded by research grants from CPA Australia and the University of Adelaide.

In their feedback to us, CPA Australia encouraged us to submit the report to the Senate Inquiry into Access of Small Business to Finance as they believe the findings are relevant to the inquiry's investigation, notably item (d) "opportunities and obstacles to other forms of financing, for example, equity to support small business 'start ups', liquidity, growth and expansion".

The purpose of our research was to investigate factors that influence the use of Private Equity (PE) amongst SMFEs in general, and specifically, whether PE investors can provide a practical solution to the upcoming succession crisis amongst SMFEs. Due to the impending retirement of the post-war baby-boomer generation, it is anticipated that around 60% of family business owners plan to retire by 2016. Although the majority of family firms intend to pass the business onto the next generation, it is predicted that half will be unable to do so due to a lack of available and / or suitable successors. As a consequence, many family owners will have little option but to sell or close down the business. The scale of this problem suggests that not all family business owners can look forward to traditional exit options such as trade sales, and therefore alternative succession strategies, such as the involvement of PE, need to be considered. The successful ownership transition of family firms (e.g. to next generation, management buy-out or sale) is critical to the Australian economy as it is estimated that a successful transfer conserves, on average, five jobs, whereas a start-up generates on average two jobs.

The main finding of this study was that the engagement of SMFE owners with PE investors is limited by the existence of finance, knowledge and empathy gaps between SMFE owners and the PE sector. Specifically:

1. **Finance gap:** the results suggest that compared with their non-family counterparts, SMFEs face a finance gap when it comes to attracting capital from PE providers due to both supply and demand factors. On the supply side, SMFEs are less likely to receive capital from PE firms because of prohibitive transaction costs, and potential risks stemming from information asymmetries (lack of transparency) and a perceived lack of professional management and practices. On the demand

side, family business owners may face a self-imposed finance gap because of their attitudes (antipathy) towards and knowledge of PE.

2. Knowledge gap: Owners' degree of knowledge and understanding of PE has a significant influence on their attitude towards using PE (regardless of whether it is for growth, restructuring ownership or exit). The results suggest that owners have limited knowledge of what PE is and how it can assist them in realising their objectives. At the same time, PE providers also have a lack of understanding of family business dynamics and what is important to family owners. Owners are most likely to approach their accountant when seeking advice on financing and PE. Also, CPA and CA qualified external accountants from larger accounting firms are perceived as being more able to advise SMFE owners on PE.
3. Empathy gap: the results suggest that SMFE owners' attitudes towards using PE are largely influenced by their intended succession/exit strategy, their understanding of PE and whether they emphasise financial or lifestyle objectives. Interestingly, there was no statistically significant difference in attitude to PE between family and non-family firms (regardless of how a family business is defined). So being a family business does not, in itself, influence attitudes to PE. Rather, it is the attributes of the owners (intended succession/exit strategy, knowledge of PE, objectives) which determine attitudes towards PE.

Based on these findings, the report proposes the following recommendations:

1. Because owners' knowledge and understanding had a significant influence over attitudes towards using PE, one way to facilitate the use of PE amongst SMFEs is through educating owners on PE and how it can assist them in ways such as growth and succession / exit. Such education could be through seminars conducted by industry and government associations, as well as family business networks such as Family Business Australia. As accountants are the preferred source of advice to owners on financing and PE, it is important that the accounting professional bodies equip their members with the requisite knowledge on PE. The results suggest that the professional bodies should target public accountants operating in small practices or as sole practitioners.
2. To lower the perceived risks, information asymmetries and transaction costs associated with investing in family firms, accountants (their preferred advisers) can assist SMFE owners in professionalising the management of the firm. Specifically, SMFEs are in need of assistance in developing strategic business plans and succession plans, the establishment of independent / advisory boards, the utilisation of outside managerial expertise and the development of performance measurement systems. In addition to accessing PE, professionalisation will benefit SMFEs in a number of ways.

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Yours sincerely,

<Submitted via e-mail>

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Encl.

Full report