Executive summary

On some estimates, family businesses account for 70 per cent of all Australian businesses. Although family owned and operated commercial enterprises are an established and enduring feature of the Australian economy, they have been overlooked by Australian governments. In part, the reason may be that they are seen principally as a subset of small and medium-sized enterprises (SMEs). Few government departments seemed to have awareness of the existence of large family businesses. It was apparent that government agencies have not focused on the characteristics of family businesses, the economic contribution these businesses make or the unique challenges they face.

Over the past seven months, the Parliamentary Joint Committee on Corporations and Financial Services has gathered and analysed evidence on a range of issues relating to family businesses. It makes 21 recommendations. The committee recognises that awareness and understanding of family businesses in Australia is nascent. However, it hopes that this report will begin a conversation within government that might give serious consideration to the questions: What is a family business? What contribution do these family businesses make to the economy and the community? How should family businesses be supported? What particular contribution do family businesses offer that other businesses do not? How can good public policy enable and enhance the success of the family business sector?

A lack of a definition and official data

There is no official definition of family business in Australia. Chapter 2 of this report identifies several possible definitions, noting the strengths and weaknesses of each. It also considers the key threshold questions that would need to be considered in devising an official definition: should sole traders be included; should extended family be part of a definition; should the owners have at least the intent to pass on the business; should there be a threshold based on the number of employees or annual turnover, as there is to identify small businesses?

Without an adequate definition of family business, there is no adequate data. The data that is available is from surveys by consultancy firms such as KPMG and MGI Australasia. The surveys are interesting and certainly provide talking points, but their accuracy and reliability are questionable. The data are compiled from small sample groups and, even among surveys conducted by the same consultancy firm, the methodology and the definition of 'family business' has changed over time.

The committee heard from family businesses in retail, tourism, agriculture, and hospitality, with turnover ranging from the hundreds of thousands to the billions of dollars.

The contribution and mindset of family businesses

Australian family businesses are diverse: they come in all sizes, operate in many sectors and have a range of operating structures (public companies, private companies, partnerships and trusts). Despite this diversity, family businesses have common features and traits that distinguish them from non-family enterprises. Chapter 4 of this report examines submitters' and witnesses' views that family businesses differ from non-family business in terms of their:

- risk averse, long-term approach;
- flexible decision-making;
- greater commitment to retaining staff;
- significant contribution to the community in which they operate; and
- higher labour productivity than non-family firms.

There is no reliable data that could test the strength of these attributes in family businesses and compare them to those in non-family businesses. However, the committee believes that these characteristics deserve the attention of policy makers. These traits could be measured based on the value of family businesses' balance sheet assets, their debt to equity ratios, the tenure of family business Chief Executive Officers, the average number of years of employee service in family businesses and the business' philanthropic contributions as reported to the Australian Taxation Office (recommendation 10).

There is Australian research that has found that the contribution of labour to the output of family firms was much greater than the relative contribution of labour to comparable non-family firms. The contribution of labour to output in family firms was also significantly greater than that of capital to output in these firms (chapter 4).

The possible influence that family businesses' size and governance structures have on their productivity and performance is an area of particular interest to the committee. It is a matter of obvious public policy interest if family businesses' governance structures and decision-making patterns can be shown to contribute to higher growth and productivity than non-family firms. The key would be to establish this case using official data.

The challenges unique to family businesses

Family businesses face particular challenges, key among which are the challenges of managing succession and internal conflict. For family businesses, business longevity is influenced not merely by productivity and economic factors. Family businesses must also manage family tension and conflict regarding the goals and direction of the business. These ructions can change governance practices and the willingness and capacity of family members to relinquish or assume control of a commercial enterprise.

Succession

The key issue of succession is discussed in chapter 5 of this report. The argument put by several submitters and witnesses is that a smooth transfer of family businesses is necessary to maintain a prosperous and growing economy. Successfully transitioning a family business, it is argued, maintains more jobs on average than a start-up firm.

Many argue that the challenge of passing the business on to the next generation is what distinguishes family businesses from non-family businesses. For first generation business owners, a critical stage in the process of managing succession is to recognise:

(a) that there is a viable entity to be passed on; and

(b) that the next generation is prepared to take on the role.

While there is some data that Australian family businesses have not adequately planned for succession—despite the impending retirement of their owners—the reasons for this are not clear. It is not apparent to the committee, for example, that there is inadequate information or advice on succession planning. Indeed, the committee is aware that the government's Enterprise Connect advisers and private consultants have considerable expertise in succession planning. There may be a lack of awareness on the part of some family businesses that these services are available. However, in many cases, it may simply be that the business has not yet reached a stage where the owners feel comfortable to put a plan in place.

The committee believes there could usefully be a public policy debate relating to the economic benefits of succession planning (recommendations 2(c) and 7). Government agencies may form a view that there is no broad-based economic benefit to ensuring that a family business is passed on, and that there is therefore no public policy need to encourage succession. The committee recognises that the family owners may themselves find an offer from the market to be more attractive than passing the business on to a reluctant successor. Nonetheless, the committee believes that debating these issues—both publicly and within government—is worthwhile. For sectors that are heavily based on family ownership, such as farming, tourism, trades, construction and transport, this debate will have particular currency.

The public policy debate on succession planning might also consider the ramifications of the impending retirement of the baby boomer generation on family businesses in Australia. On one estimate, 61 per cent of family business owners plan to retire between 2006 and 2016 (see chapters 3 and 5). However, the exact number of retirements and the effect it may have on the family business landscape, and the Australian economy, is unclear. Without reliable longitudinal data, the economic consequences of the baby boomers' retirement are largely unknown. The committee believes that this is an area in which government should consider collecting official data (recommendation 11).

The 50 non-employee shareholder rule

For families trading as companies, the incorporation of the family unit within the business model also presents a key challenge that is unique to the sector. Section 113 of the *Corporations Act 2001* states that a proprietary company must have no more than 50 non-employee shareholders. It must otherwise form as an unlisted public company, and comply with the disclosure obligations of public companies.

Family business representatives argued that family companies with successive generations of shareholders can exceed 50 shareholders, which unfairly forces them to relinquish family control and triggers reporting obligations. In a 2008 inquiry conducted by this committee, the FBA suggested increasing the section 113 threshold to 300 shareholders. The committee proposed an increase to 100 non-employee shareholders. However, the government made no change to section 113. Then, as now, it argued that companies with more than 50 non-employee shareholders have a sufficiently diverse ownership base to justify greater governance requirements.

The committee remains unconvinced. For successful, multi-generational family businesses, the restriction in section 113 on the number of non-employee shareholders in a proprietary company may mean that large family businesses incur additional costs. This appears to be at odds with the broader policy objective of facilitating and supporting long-term business growth.

However, it does not seem that a clear and precise case for increasing the section 113 threshold has yet been put to Treasury. Family business representatives and large family businesses themselves need to put specific cases directly to government to show that the current threshold:

- limits the expansion of family businesses beyond 50 non-employee shareholders;
- has had an adverse effect on family businesses that have passed the threshold and incorporated (see recommendation 13); or
- forces family businesses into structures that members might not otherwise choose.

In addition, the committee recommends that the Australian Bureau of Statistics (ABS) collect data on the effect of section 113 of the Corporations Act on Australian businesses, including family businesses (recommendation 17).

Family trusts

Family trusts are an established feature of the family business sector. Family businesses, and their representatives, disputed the view that family trusts are designed to minimise taxation. Family businesses can choose to adopt a trust structure for reasons that include asset protection, assisting the business to manage succession and related estate planning issues, and providing a mechanism to retain control of the business within the family unit. Within the family business sector, trusts are viewed as a legitimate means of conducting a commercial enterprise.

For family businesses trading through a discretionary trust structure, the committee heard that the existing legislative frameworks across the Commonwealth, States and Territories present various challenges. In particular, family businesses reported that the requirements in Division 6 and Division 7A of the *Income Tax Assessment Act 1936* do not appropriately recognise the operational structures of family businesses which can include multiple private commercial enterprises.

Australia's taxation requirements should achieve an appropriate balance between supporting businesses and maintaining the integrity of Australia's taxation system. There is some evidence that at present Division 6 and Division 7A may not be achieving this balance. The committee recommends that the Board of Taxation consider the evidence presented by the family business sector on the effect of Division 7A on business performance (recommendation 12). There is evidence to support the view that the current operation of the rules in Division 6 is unclear, uncertain and, accordingly, create unnecessary complexity for Australian businesses. Division 6 is currently under review. Given that the Division 6 requirements affect family businesses, the sector should be recognised, and included, in the review process (recommendation 14).

Trusts—the 80 year rule

Another legislative area of concern is the rule against perpetuities: the so-called 80 year rule. A creature of common law and State and Territory legislation, the rule limits the lifespan of the family trading trust and, by extension, family businesses operating through a trading trust structure.

While the precise number of family trading trusts that will be affected by the 80 year rule in the coming decades is presently unclear, it is clear that the rule is an example of Australia's legal system not keeping pace with developments in the business sector. The committee draws attention to concerns that the rule could stop family businesses founded on a trust structure from operating. It is essential that State and Territory governments consider whether the rule continues to be appropriate for Australia's modern economy.

The committee recommends that the Council of Australian Governments (COAG), or its relevant Ministerial Council, inquire into whether the rule against perpetuities can be abolished in each jurisdiction, or whether its scope can be limited to appropriately exclude commercial arrangements. South Australia abolished the rule in 1996. The experience of trading trusts established in South Australia since then will provide a basis for determining the likely effect of abolishing the rule. If COAG determines that it is not appropriate to abolish or amend the rule, it should actively engage with the business sector to alert trading trusts to the financial implications of the vesting requirements (recommendation 15).

Access to finance

The mindset and priorities of family businesses can influence the financial resources accessed by family enterprises. There are certainly challenges common to both family and non-family businesses, such as the lack of competition in the authorised deposit-taking institutions (ADI) market and the interest rates for business finance. However, in terms of accessing finance, family businesses appear to face particular difficulties. The conservative, family-oriented mindset of family businesses can deter them from accessing otherwise viable forms of finance, such as private equity.

An analysis of the sector's access to finance also indicates the need for greater recognition for family businesses as distinct from non-family enterprises. ADIs do not consider family businesses separately from non-family enterprises when determining the risk attached to a family business' finance application. It would seem that ADIs are failing to understand and engage with the family business sector. The committee encourages ADIs to analyse the characteristics of family businesses, as distinct from broader categories of micro, small, medium, or large businesses.

Given the prevalence of family businesses in Australia's business landscape, the Reserve Bank of Australia's (RBA) apparently limited engagement with the family business sector should also be addressed. The committee recommends that the RBA include family business representatives on its annual small business panel in each state and territory (recommendation 21).

Family businesses and the Global Financial Crisis

The contributions of, and the challenges unique to, the family business sector are of relevance to the broader business community. In part, this inquiry responded to anecdotal evidence that the family business sector proved particularly resilient in response to the Global Financial Crisis (GFC). The committee cannot conclude that the family business sector in Australia outperformed non-family businesses in response to the GFC. The anecdotal evidence and the data are inconclusive.

However, there is certainly international evidence that family businesses weathered the GFC better than non-family businesses. There is also evidence to support the conclusion that family businesses' 'patient capital' approach provides a safeguard in times of economic downturn. The sector's contribution to the Australian economy includes the promotion of the benefits of a risk adverse, long-term approach to investment and business profitability. While its effects cannot be measured on available data, the committee considers that it is an approach that the broader economy would be well-advised to consider.

Beginning the conversation within government

The main purpose of this report is to further the conversation within government about family business issues that this inquiry has started. At this early stage, it would be counterproductive for the committee to present a conclusive definition of family business to be used by policymakers in Australia. Rather, the committee recommends that an Inter-Departmental Committee (IDC) be established to consider:

(a) the issues that are particularly or uniquely relevant to family business and how these issues interconnect with distinct policy areas; and

(b) how a definition can capture these issues (recommendations 1 and 2).

To this end, the key issues that the IDC should consider are:

- identifying the number of family businesses, their location and the industries in which they operate (recommendation 2(e));
  - the need for policy makers to identify the number of family businesses that are small businesses, and if so, whether the definition of small business should be based on the threshold used for tax purposes (annual turnover of less than $2 million) or the ABS's threshold of fewer than 20 employees (recommendation 2(a));
  - the need for policy makers to identify first, second, third and later generation family businesses (recommendation 2(d));
  - the need for policy makers to identify the number of family businesses established from culturally and linguistically diverse communities (recommendation 2(f)); and
- the need for data on family businesses' contribution to Gross Domestic Product, employment and export earnings (recommendation 8);
- the importance of succession as a policy objective, and whether a definition should identify whether the owners could pass the business on, whether they intend to pass it on, whether they have a formal plan to do so (recommendation 2(c));
- the need to gather data on family businesses, should could include questions on the value of assets and balance sheets, debt-to-equity ratios, the tenure of Chief Executive Officers, the average number of years of employee service, and the sector's philanthropic contributions (recommendation 10);
- the effect of section 113 of the *Corporations Act 2001* and the need to identify the number of non-employee shareholders in family businesses (recommendation 2(g));
- the effect of Division 6 and Division 7A of the *Income Tax Assessment Act 1936* on family businesses that operate through a trust structure; and
- the effect of Division 83A of the *Income Tax Assessment Act 1997* and section 113 of the Corporations Act on family businesses trading as companies.

The committee holds that both policy makers and stakeholders have an important role to play in the creation of an official survey of family business (see recommendation 3). The joint development of a survey would then provide for the development of stronger links and understanding between government and the family business sector. With official data gathered, the dimensions and the nature of the sector will become clearer. There will then be the need for discussion between government, family businesses, consultancies and academics about what the findings mean and how, if at all, they should be acted on.

It is clear as a result of this inquiry that family businesses have been a largely unrecognised part of Australia's economy. This report records the first step towards understanding these businesses as distinct and unique contributors to the Australian economy and community. The principal purpose of this report is to begin a discussion within government about the policy need to identify a family business, which may then lead to an official definition and official data collection. The committee also argues, however, that there is an onus on the family business sector to harness the momentum generated by this inquiry to increase its engagement with government.