KPMG

FBA
Family Business Australia

KPMG and Family Business Australia Survey of the Next Generation of Family Business

AUSTRALIA

AUDIT ▪ TAX ▪ ADVISORY

Introduction

Moving a family business from the ownership and control of one generation to the next is a seminal event for both the businesses and families concerned. Indeed, it is this generational transition that distinguishes a true 'family business' from one that is merely owned and managed by a single family.

Despite their obvious importance, surprisingly little is known about the next generation of family business as a demographic. The factors that will determine the success or failure of intergenerational transition of a business are complex, yet overwhelmingly the outcomes will depend on the attitudes and attributes of the individuals concerned. Understanding this next generation (or next gen) of family business is becoming more critical to ensure this transition continues and is executed with as little disruption as possible.

Intergenerational transition signals not only change in the management of a business, but can also affect its governance and strategy in varied and unexpected ways. Typically, a family business will be the creation of an individual or couple who eventually turn the business over to one or more of their children. In turn, the second generation might pass on the business to a third generation. Along the way, the number of business owners or beneficiaries is likely to increase via inheritance and marriage. The interests of these parties will probably diverge over time, particularly between those who work in the business and those who do not.

With the passage of time, managing family relationships can become as time consuming and difficult as managing the business itself. Some observers believe that, in countries like Australia, third and fourth-generation family businesses tend to be inherently unstable because of the differing expectations and aspirations of family members. Moreover these differences can take on distinct generational complexities.

What is clear is that the majority of family businesses fail to succeed past the third generation. In fact, research by Boston-based Family Firm Institute[1] revealed that only one-third of all family business are passed on to the next generation successfully, giving credence to the saying 'shirt sleeves to shirt sleeves in three generations'. The costs of these inept transitions to families, businesses and the broader economy are considerable and many businesses experience more pain and disruption than is necessary during this process.

1. Poza, Ernesto (2010), Family Business, 3e (South Western), p.179

About the survey

In an effort to better understand the dynamics of generational succession in family businesses, Family Business Australia[2] and KPMG have surveyed members of the next generation currently working in family businesses, either as owners and managers in their own right or preparing to take on that role.

Our survey responses covered 60 individuals spread across five states. Nearly two thirds of respondents were second generation while less than 10 percent were drawn from fourth and subsequent generations. To supplement our survey findings and put a more human face to the issues uncovered, we conducted four separate focus groups involving selected next generation representatives.

The survey findings and our associated observations form the basis of this paper. The quotations highlighted are the actual contributions of focus group participants. The paper is structured under six key discussion areas.

1. Preparing for succession
2. Changing leadership
3. Forging new directions
4. Governance as a priority
5. Measuring performance
6. Pride in the family business

Neither Family Business Australia nor KPMG would contend that this paper represents the final word on intergenerational transition in family business in Australia — the succession of a family business is as unique as the family itself. Nevertheless we believe this document provides worthwhile insights into the nature of intergenerational transition and offers some ideas on how the process can be improved for the benefit of all involved.

We trust our paper will be of value to those on either side of intergenerational transitions and might provoke thought in some, about ways to best prepare for this most challenging of businesses transitions.

KPMG and Family Business Australia would like to thank all the survey participants for their contribution and extend a special thank you to all those who gave us their time to participate in our focus groups.

2. Family Business Australia is the peak body for family and private business in Australia. Its members include multi-generational family businesses, first-generation operators, multi-sibling/cousin owned businesses and their advisers.

Preparing for succession

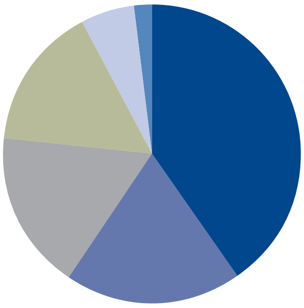
Nearly two thirds of our survey respondents said that working in the family business is where they 'always wanted to be'. Fewer than one in 10 appeared to be reluctant participants in the business, admitting that their decision to join the business was made under pressure.

Interestingly, it would appear that the entry of younger generations into family businesses is rarely a totally informal or haphazard process. Thirty percent of respondents said that formal conditions were in place dictating their entry to the family business. The majority of these formal rules were focused on attaining a formal tertiary qualification and in many cases, also gaining outside work experience. As one focus group participant commented, *"My father told me to spend someone else's money making mistakes, before I was ready to join the family business"*.

Of the remainder, where no formal rules were in place for entry to the business, our focus group participants widely agreed that a tertiary education was an implicit expectation prior to joining the family business.

As Figure 1 clearly demonstrates, the current new generation of family business entrants is remarkably well educated with a high proportion having completed a tertiary qualification. More than 75 percent of respondents had completed some vocational or tertiary training after leaving school, and 20 percent of these were at a postgraduate level. These figures are significantly higher than those of the population at large.

Figure 1: Highest level of education of next generation business entrants



Undergraduate qualification (degree/bachelor)	40.38%
Postgraduate qualification (masters)	19.23%
Diploma	17.32%
Completed year 12	15.38%
Completed year 10	5.77%
Trade qualification	1.92%

Our focus group participants held robust discussions on the role education plays in a family business today. It was generally agreed that further education is more essential for the ongoing development of an existing business, and that the increasing complexities of business these days add to this prerequisite. Many commented that the founders of their business started out through a necessity or a passion to succeed and that education had not been as important in creating their vision.

"For my father, education was not a factor. They didn't foresee that this would be a business with a long-term focus. They started a business to support their families — they worked hard to put us through school and pay the bills".

"By the second and third generation, a business needs the rigour that education provides".

"Getting a qualification that was different to my father meant I was allowed a high degree of freedom to bring my own skills and knowledge into the business, because they were skills my father didn't have. He respects my different skill set. As I provide value to the business that respect increases".

Focus group participants.

The value of external business experience was also a key topic of discussion and having worked outside the family enterprise was generally thought to provide a broader and more balanced perspective on business matters. As one next gen participant put it, *"working outside the family business taught me how people were prepared to rip off a company if an opportunity arose and how blasé they could be in dealing with other people's money"*. All focus group participants agreed that working in a family business meant you were much more cost conscious because the money you were spending was *"more or less your own"*.

Overall our focus group participants agreed that entry rules regarding education and experience should be encouraged and even written up formally for future generations.

"This is not only good for the family, but it's also good for the other staff in the business who can see a clear prerequisite for family members to join the business, which in turn is better for the culture of the business".

Focus group participant.

The potential issues that arise from being the boss' son or daughter was widely appreciated. More than 85 percent of our respondents felt family members should compete fairly with non-family employees for promotions and career opportunities. Of course, while such sensitivity is admirable, the reality is that next gens can look forward to one day owning the business, a status that inevitably sets them apart from other employees. Three quarters of next gen respondents reported that other members of staff placed greater expectations on them precisely because they were family members.

"It should be the best person for the job. Board positions are different. Directors (in our business) are shareholders".

"If a role is created just for you, instead of for a real business need, then it makes it more difficult to build respect with other staff".

"The fact is that family members who work for our business work damn hard. We put pressure on ourselves that non-family members do not".

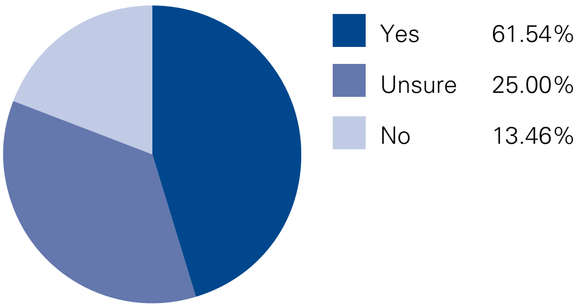
"I think sometimes it is hard to be a family member as the qualifications of the family member are not looked at as being equal to those of a non-family member".

Focus group participants.

Changing leadership

More than 60 percent of the next gen surveyed felt that their style of leadership was different to the present or former incumbent (see figure 2). A discussion around this statistic found that the next generation are very optimistic about their styles of leadership and indicated that this generation believe they are more ‘people-centric’ than the former. Some also acknowledged that their optimism might be a result of not having experienced any really bad times that have tested their ability to manage and make critical decisions.

Figure 2: Difference of leadership with incumbent



"I'm a bit younger, more optimistic and haven't experienced any really bad times as a result of decisions I've had to make or as a consequence of decisions made by others".

"There was an expectation (from the staff) that the new family leader would be the same as the incumbent. It was difficult to take them all on the journey of change that I (as a next generation leader) was trying to encourage".

Focus group participants.

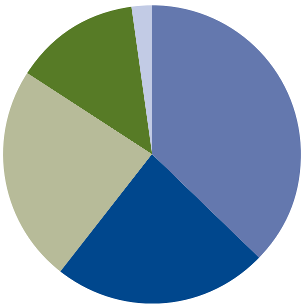
Despite a strongly perceived difference in leadership styles, our survey did not find a correlation with the degree of intergenerational tension. Sixty-eight percent of the next gens surveyed reported they enjoyed (or had enjoyed) 'excellent' relations with the incumbent owner/manager. A further 22 percent reported 'good' relations.

Even amongst the siblings, conflict and tension was hardly a consideration. Fifty-nine percent of survey respondents said they worked in the family business with siblings. Close on two-thirds of these worked with two or more siblings. Forty-eight percent claimed they always felt comfortable working with their siblings while a further 42 percent said they were comfortable working with their siblings 'most of the time'.

Forging new directions

More than one-third of respondents said that when taking over the position of leadership from their incumbent, business strategy would be their priority for change. Twenty-three percent believed that management and governance would be key areas for development, while cultural change was clearly a fourth priority.

Figure 3: The next generation's priorities for change



Business strategy	37.25%
Governance structures	23.53%
Management (structure/style)	23.53%
Cultural change	13.73%
Other	1.96%

Each of the focus group sessions held colourful conversations about whether the focus on changing business strategy was due to the life stage of the business or a function of the environment. However in both cases, it was agreed that diversification and growth cannot be achieved without a more comprehensive strategy, and a solid foundation.

"Our business has grown organically over time and is still quite informal. I am hoping to professionalise it and bring it up to the next level".

Focus group participant.

Some participants felt that changes to the business strategy were necessary for the next generation to forge a path for themselves in terms of progression.

"If my role had always stayed the same, working for my father, I would have gone crazy".

"As a second generation we're constantly thinking of ways to drive new initiatives".

"You can get very stale, you need to explore and create opportunities".

Focus group participants.

It was also agreed that many next gens are likely to become more conservative managers than their parents. According to one focus group participant, *"businesses are becoming more risk averse and will be less entrepreneurial than in the past because the business climate no longer supports those behaviours. Things such as reporting requirements have destroyed this and in the future entrepreneurship will be more conservative".*

Others see their role in the family business to be more of a custodian of their respective businesses. *"When I go to work,"* explained one, *"I'm building a business for the future of my family. I'm sure that's not the way my father thought"*. They agree that this has also affected their adversity to risk. *"When you're a custodian, you do have to play by more rules. Our business has a reputation and brand to uphold now"*. Yet, to many respondents, the same role as a custodian means they are expected to continue progression and keep the business strategy moving through necessity.

"We have to do better than the incumbents did; it's an implicit benchmark".

"We have an obligation to do better – because our families started with so little. Being educated also creates more of an obligation".

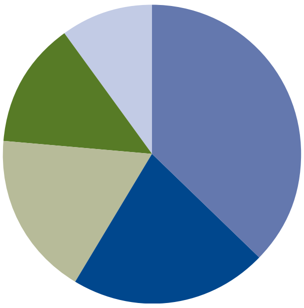
"We're committed long term managers / owners and we plan to hand down to the next generation so we have to keep moving forward".

Focus group participants.

Making governance a priority

An overwhelming 96 percent of survey respondents believe governance is an important element in the future of the family business. When asked whether they plan to embrace the existing governance structure, more than 60 percent said they would be implementing changes (be they major or minor) and a further 18 percent were unsure, as demonstrated by Figure 4.

Figure 4: Attitudes to governance structures in the family business



I propose minor changes	37.25%
I think the current structure is working optimally	21.57%
Undecided	17.65%
I will completely change the current governance structure	13.73%
I propose major changes	9.80%

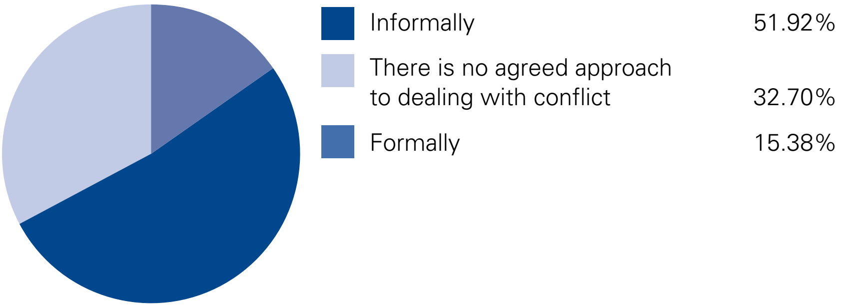
While these figures are encouraging, there is still a gap worth highlighting. The 2009 KPMG/FBA survey of current family business leaders disclosed that only a little over a third of the businesses covered by the study actually possessed a formal board of directors or other governing body. Thus it seems there is a long way to go before such approaches become commonplace. Yet it is a role that the next generation seem eager to harness and make their own.

Next gens thinking on governance appears to centre primarily on interactions with management (30 percent of respondents) and the board (27 percent). However, 46 percent of respondents did not undertake any formal review of their governance processes and a further 15 percent conducted only irregular and informal governance reviews.

Where reviews are undertaken, nearly two thirds are conducted internally.

Of further interest is the fact that only 15 percent of family businesses have a formal process in place for dealing with conflict (Figure 5). In a business where relationships are central to its operations, this should be a concerning figure.

Figure 5: Dealing with conflict



"There is such a fine line when you deal with family. Your relationship with your family is so important".

"We'd sit around the dinner table having blues, and spoiling a Sunday night roast, because we were discussing business and our individual roles, and our different outlooks on the business were causing conflict".

Focus group participants.

The increased prioritisation of governance reflects the evolving business structures that are unavoidably becoming more complex and uncertain, not to mention litigious. Family business will most often have the added dimension of how to accommodate new family members into the business such as the next generation or new in-laws. Additionally, there are complexities surrounding ownership and management structures and how these interact or overlap with appointments to the board.

"My father doesn't really see the need for it (governance). But from a next generation perspective there is more politics going on at the family level between siblings. We need a way of resolving the issues. You can look at governance from a purely business perspective, but we have the challenge of adding family governance to business governance. It is hard to keep them separate".

"Family members who have come into the business without rules have caused the only problems within the business. The family issues are the ones that have made it particularly hard. Relationships have fallen apart".

"We've got quite a complex number of family members in the business. We've all worked hard to get the business where it is today, and it's important to protect it. It's super important".

Focus group participants.

Marriage — and marriage breakdown — is a common family business complication, including the potential role in the business for in-laws. The arrival of new in-laws in a business can result in the injection of additional skills and bring a fresh perspective to both commercial and family matters.

Talking about in-laws within a family business:

"They are often removed enough to do the job well. They have the separation to sit back and make more objective decisions. They tend to be able to balance the family politics more evenly".

"What a tough and difficult job, to be an in-law in a family business".

"Often in-laws are more diplomatic, they're a good buffer from the family, if there are things to be done that are not too popular".

Focus group participants.

However the entry of in-laws can also be a disruptive and value diminishing event. Relationship breakdowns and divorce add a further potential complication to the mix. These are situations in which family loyalties and the interests of the business can collide. Divorce settlements can place unanticipated financial pressures on a business and its owners. As one participant notes, *"We've been through a divorce in the business. My brother-in-law was the CEO. So it took a good time to manage him out of the business. We weren't prepared for that situation".*

Circumstances will dictate how these matters are managed in practice, although establishing in advance some principles and guidelines for handling them should enhance the quality of the relevant decision-making.

Governance also involves protecting and enhancing the reputation of the business. This becomes doubly important in the case of a family business in which the reputation of the business and that of the family are typically intertwined. The problem is compounded when the family name is also the business name.

One thing that became clear from the focus groups was that governance concerns extend beyond the business to include the family itself. Because the interests of individual family members are not always well aligned with the needs of the business, the development of formal mechanisms to discuss and resolve internal family differences vis-a-vis the business can head off a lot of intra-family disputation and animosity. These mechanisms can take various forms, including family councils and/or family constitutions. Sometimes these structures involve external moderators or facilitators.

"The family constitution is ongoing and will be for the rest of my working life. It changes frequently. It's a growing document".

"We had no concept of governance. It's one of the greatest things I've taken so far out of our relationship with Family Business Australia — the need and importance of governance".

"The family business council prevents infighting and conflict".

"It could be argued that the issue of family governance is more the difference in sophistication between generations than it is about specific rules of entry".

"Not having family governance structures in place is the sort of thing that can catch up with you because no one foresees their family having real issues".

Focus group participants.

The need for such structures typically becomes more acute as control of the business passes through succeeding generations and the number of family members with an interest in the enterprise increases. These are a means of reconciling the ambitions of individual family members with the financial needs of the business. They also allow for more effective succession planning and, for example, the formulation of measures to buy-out family members who wish to realise their share of the business.

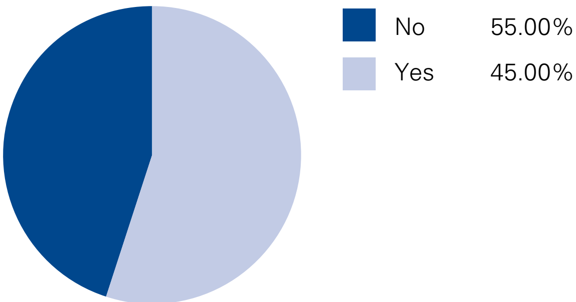
Intergenerational transfers also often take place at a time when the business itself is outgrowing its original management culture and practices. There can be a pressing need for more structured and disciplined risk management and regulatory compliance processes. Our survey has found that for many, it may well take a generational transition to prepare the way to create contingencies to these unique challenges.

Measuring performance

Our survey found that the remuneration and performance assessment of family members working in the business is often lacking the transparency of this process in a non-family business.

Fifty-five percent of respondents said they were not satisfied with their performance review process and a further 50 percent said their salaries were not benchmarked with similar roles outside the family business. When asked about performance assessments, one focus group participant responded that *"being performance assessed by my Dad seems like a really strange way of doing things"*.

Figure 6: Satisfaction with performance reviews



There are no simple answers here. An across-the-board policy of openness and honesty in workplace communication is a good starting point. Where possible, avoid a family member being directly assessed by another family member, and if this is not possible, perhaps consider the inclusion of an independent third-party in the process.

Assessing performance on the basis of hard, numeric key performance indicators (KPIs) can also help to keep reviews as impersonal as is possible. And of course both the performance assessment and the remuneration of family members ought as a general rule to adhere to the same standards as those that apply to non-family employees.

"We now have goals aligned to our positions, but this is only a recent development. Trying to push this change up the chain we received a lot of resistance. A business coach is helping put goals and processes in place to make transition and change smoother. Otherwise there could be a huge void between owners and managers".

Focus group participant.

It is important to remember that family members are often also owners of the business and thus benefit from any increase in the net value of the business, as well as presumably participating in any dividend distributions or proprietors' drawings. The separation of equity is an issue that should be considered separately and not in consideration of a performance and remuneration framework. In this space, our next gen focus group participants who were more established, provided some insight to the rest of the group on the benefits of getting the lines of reporting right.

"We have no family members in hierarchical conflict positions. This goes right to the heart of how the external world views you, particularly financiers. If a bank thinks that the daughters are reporting to the father and so on, they'll be asking questions about objectivity and probity. Financiers love to see a rigorous governance structure".

"If you surround yourself with good advisers, someone who knows your business, knows what the expectations are and where you're headed, then you can get that objectivity in there, despite the number of people in the business".

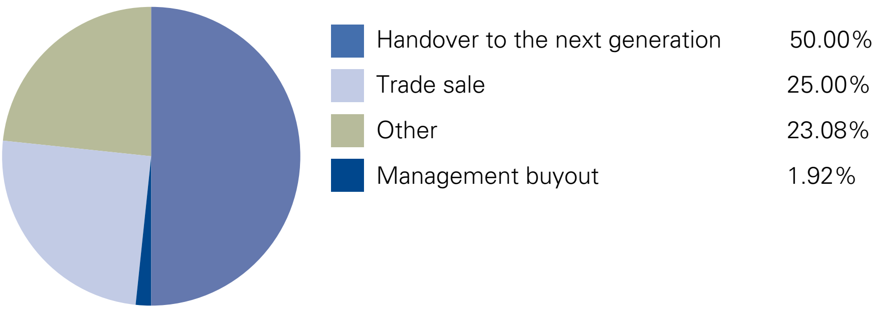
Focus group participants.

Pride in the family business

Planning and preparation can help make generational transition a smoother and more satisfying experience. And as discussed previously, inter-generational transfer of ownership and control can be a recipe for ongoing conflict if the legitimate interests of all family members are not taken into account when the transfer is being contemplated. The business will not look after itself and family relationships will be affected by business considerations. Sometimes selling the business and moving on is the best result for everyone.

To this end, we were surprised that 50 percent of our surveyed next gens had firm plans to hand over the business in due course to the following generation (Figure 7).

Figure 7: Plans for exiting the business



Just as reassuring were comments from our focus group participants who continually reinforced the role that pride in the family business plays; as one stated: *"if you don't have it, then why would you do it".*

"When you work in your own family business you actually have the opportunity to change things, to really make a difference. When I've worked in other places, you're only making a small contribution to change. It's like trying to turn a huge boat around. In family businesses the impact is more immediate and the opportunity is a lot closer".

Focus group participant.

Still, for most of those next generation surveyed, issues involved in the transition to a new generation of owners and managers are not of immediate concern. Thus 50 percent of respondents said they intended to remain in the business for more than 20 years. A further 23 percent indicated they would be staying around for 16 to 20 years.

These answers are relative as they were not benchmarked against the age of a respondent upon entering the business. However, it is safe to assume that close to 75 percent of respondents see the family business to be where they will spend the majority of their career and perhaps even where they will end their career.

Our focus group participants had fruitful discussions about how the 'next-next generation' should be inducted into the family business, now with the hindsight of their own succession experience. Interestingly, one participant identified history as the vital ingredient in bringing the next generation into the family business. *"We are documenting our family business history now because it's just such a huge piece of our business. For our generation, we didn't have this. A lot of what we learnt was just via osmosis, through other people that worked in the business, not from Dad"*.

"They [the younger generation] need to understand that the business is not theirs to sell, that it's owned collectively. It's not a right, it's an honour. They need to understand that there will be a role there if they want it, but they need to earn their stripes".

"Our next gen started on reception; they all carried on when we told them that was their starting point – despite their qualifications. But it has worked. They know everybody, they know what everyone does, and they know what the problems are because they get to talk to the customers and because they are the front line. It was the best training, it doesn't matter who they are".

Focus group participants.

Our final question asked participants about the development of self-identity in the family business. Sixty-seven percent of participants responded that they did feel the need to develop their own identify in the business and 75 percent said that the expectations placed on them were greater than on other staff.

"The challenge is respecting how things have been done before while still trying to create your own identity".

"If you can find a niche for yourself within the business and make it your own, one that is different to the incumbent, that is the best way to start building that identity".

"I spent a lot of time wondering how I was going to fill his shoes. It took a long time to figure that I didn't need to fill his shoes, that I've got my own shoes and I'll do the best I can. I needed to form my own identity for myself, not for anyone else".

"As you get older, you do look at things differently. Now I think we're lucky to have four sets of shoes – four of us – to fill his one set of shoes".

Focus group participants.

Conclusion

Overall, the optimism of findings from the next generation survey has positively reinforced the impression that many family businesses possess characteristics and qualities that set them apart from other organisations and business models.

Indeed, there has always been a widely held perception that family businesses have a competitive business advantage that big business can only attempt to emulate; a passion for business that resonates with their customers; a long-term commitment and investment in the business; and from a financial perspective, they are likely to be conservatively geared.

All of our focus group participants agreed that their greatest competitive advantage, despite their industry, was the fact that they are a family business. Our survey has shown that going forward this advantage will be augmented by a next generation of more educated and experienced leaders. Professional management structures will be enhanced by a greater appreciation of the role of governance, and business strategy will be challenged from a solid foundation.

"Through the GFC there has not been one family business I know of that has suffered really badly as a result of the economic climate. In the case of our family, it's been a great time for us because people were nervous and chose to go to companies with names that they trusted. People are more likely to trust a family business".

"What's great about a family business is that when things get busy, you put on the work clothes and you go out to help. You get your hands dirty too. That never goes away. That type of leadership is what people love. You don't just come in and sit in your office and that's it".

Focus group participants

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
Peter Chilman
+61 8 8982 9000
pchilman@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
Robert Kelly
+61 8 9263 7320
rkelly@kpmg.com.au

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

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

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

Family Business Australia (FBA) classify the Next Generation as anyone within their family business who is working with and/or influenced by a generation above. To aid the development of this emerging group of family business leaders, FBA established the Next Generation Group in 2005. Next Generation forum groups operate across all states, to motivate and support the development of members, whilst indirectly assisting the wider family business unit to prepare for succession and its many challenges.

For further information about **FBA's Next Generation Group**, or one of their state forums, 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**

kpmg.com.au

April 2010. QLDN05474MMA.