KPMG

FBA
Family Business Australia

Family businesses: Optimistic, entrepreneurial, open to disruptive technologies

KPMG and Family Business Australia

Family Business Survey 2015

THE UNIVERSITY of ADELAIDE

Welcome

Family businesses make a significant contribution to the Australian economy, representing approximately two thirds of the business community. As the longest running Australian survey into family businesses, KPMG and Family Business Australia (FBA) are delighted once again to share our latest *Family Business Survey* results.

This survey comes at a critical time, not only in terms of demographics with baby boomers exiting the workforce, but also in a rapidly changing and uncertain business climate. Business leaders will need to adapt not only their business models, but also their management/leadership styles to embrace this change. In this setting, it is encouraging to see that around 80 percent of survey respondents are feeling optimistic about their future growth prospects, and looking to invest in staff and/or assets to seize future opportunities.

Since 2005, we have sought to better understand the unique nature, opportunities and challenges of family owned businesses, and in this year's survey we have gone deeper, to identify the characteristics of high performing family businesses.

It is no surprise that family businesses with an entrepreneurial culture are outperforming others. Innovation, the willingness to take risks, delegate authority and proactively seek new ideas and opportunities are all important attributes for developing a sustainable competitive advantage, that technology can help to harness. Many family businesses have been born out of innovation. Recognising a niche in the market and with limited resources, they have had to innovate to compete. However, as these businesses grow and put in place controls and processes to support that growth, they need to be mindful that they don't stifle the very essence of the original innovation which created the business. It is reassuring to see our survey results confirming that family business governance mechanisms are evolving, allowing for the agreement and communication of the expectations of the family, the business and shareholders.

We would like to thank all of our survey participants, whether it be through the survey questionnaire, focus groups or interviews.

We would also like to recognise and thank Dr Chris Graves and Dr Jill Thomas from the University of Adelaide's FBERG for conducting the survey.

We trust you will find the survey findings valuable as you plan for the future of the family and the business.

Robin Buckham
CEO
Family Business Australia

Bill Noye
Partner
National Leader for Family Business
KPMG Private Enterprise

Contents

Executive summary

OBJECTIVES AND PERFORMANCE

Top business objectives:

1. Product and service quality
2. Cash flow
3. Net profit

Top family objectives:

1. Financial security for the family
2. Personal challenge, satisfaction and rewards
3. Quality of life outside of work

Characteristics of high performing family businesses:

- Have a **CEO** who is between **51 and 60 years of age**
- Have **diversity** in their leadership/governance team
- Utilise **governance** mechanisms that facilitate **agreement and communication** of expectations of the family, the business and shareholders
- Adopt business management practices that focus on what is happening **outside** the business
- Have an **entrepreneurial culture**
- Are able to access the **financial resources** necessary to implement their strategies

MANAGING AND RESOLVING CONFLICT

Over **80%** indicated they had experienced conflict/tension between family members over the last 12 months

Sources of conflict:

TOP 3

1. Vision, goals and strategy
2. Balancing the needs of the business vs the family
3. Lack of family communication

Those with a Family Council were significantly less likely to have experienced conflict

EVOLVING GOVERNANCE MECHANISMS

The adoption of formal governance mechanisms is increasing

52% Formal board	**43%** Shareholders' agreement	**31%** Family constitution
39% 2011	36% 2013	20% 2011

TECHNOLOGICAL CHANGE AND FUTURE OUTLOOK

78%
feel **optimistic** about their future growth prospects

51%
believe technological change is creating disruptions in the way business is done – but overwhelmingly a **positive** impact

Technological change is having a positive effect on business (regardless of industry), improving:

1. The way they manage their business
2. Their internal business processes
3. The way they interact with customers
4. The viability of their current business model
5. The way they interact with their suppliers

However,

23%
believe technological change is increasing the level of competition (35% in the manufacturing sector)

21%
believe technological change is increasing the costs associated with doing business

64%
are completely/mostly satisfied with the access to financial resources for activities and strategies

69%
believe they will need to invest in additional staff/assets to seize opportunities

70%
are very/extremely concerned with **increasing costs** of doing business

Threats to future growth prospects:

TOP 3

1. increasing costs
2. increasing tax burden
3. government response to current economic conditions

PREPARING FOR LEADERSHIP AND OWNERSHIP TRANSITIONS

Leadership:

76% of firms expected to appoint a new CEO in the next 5 years

60% of these firms intend to pass on leadership to a family member

55% of those passing on leadership in the next 2-3 years do not believe their successor is ready

Ownership:

72% expected to have some transfer of ownership in the next 5 years

64% of these firms intend to pass ownership solely to family members

CEOs believe their potential successor needs to work on:

1. Financial management
2. Strategic planning
3. Leading/managing people

Family businesses appear to be ill-prepared for exit/succession – however overall are more prepared than in 2013.

	2013	→	2015
A unifying strategy for the future of the business	19%	→	27%
Retirement plan for current CEO/MD	9%	→	9%
Preparing and training a successor before succession	12%	→	14%
Process for appointing new CEO/MD	8%	→	12%
Ownership transfer or sale plan	10%	→	21%
Estate plans	30%	→	42%

Section 1: Objectives, strategies and characteristics of high performing family businesses

During the 20th Century, several leading economic theorists argued that family-owned businesses were relics of an earlier era, and would soon be surpassed by firms embracing modern capitalism where attracting external capital and talent are paramount for survival.

Top business objectives:

2015	2013	
1	2	Product and service quality
2	1	Cash flow
3	3	Net profit
4	5	Sales growth
5	4	Productivity

Top family objectives:

2015	2013	
1	1	Financial security for the family
2	2	Personal challenge, satisfaction and rewards
3	n/a	Quality of life outside of work
4	3	Quality of life at work
5	6	Family cohesiveness, supportiveness and loyalty

As an example, in the early 1970s, a prominent Harvard Business professor argued that family members working together in business was an *economically flawed model* and that the best thing for them was to move to *professional (i.e. non-family) management* as quickly as possible[1]. However, a recent special feature on business families in 'The Economist'[2] argues that the persistent dominance and superior performance of the families-in-business model around the world puts modern theory of the firm on its head. It concludes by stating "put companies and families together and you have a uniquely potent combination".

In our previous 2013 survey, family businesses identified characteristics such as family ethos, values and cohesion, family brand, customer service, agile decision-making and ability to take a long-term perspective as their competitive strengths. Although there is growing evidence to suggest that family businesses outperform their non-family counterparts, what is not well understood is why some family businesses perform better than others. As a consequence, in addition to identifying the primary objectives of family businesses and the strategies used to achieve them, in this year's survey we focussed on identifying the characteristics of high performing family businesses.

Business and family objectives

One of the unique characteristics of family businesses is that they are more likely to pursue multiple goals that are of relevance to both the needs of the family and the business. The top five business and family objectives identified in this year's survey are listed to the left.

1. Levinson, H. (1971). Conflicts That Plague Family Businesses. Harvard Business Review, 49(2), 90-98.
2. The Economist (2015), 'Dynasties: The Enduring Power of Families in Business and Politics, April 18th–24th.

TYPE OF BUSINESS STRATEGY ADOPTED

43% **Defender**

"We stick to what we know how to do and do it as well as or better than anyone else."

1st Generation	2nd – 4th Generation	5th+ Generation	Small	Medium	Large
33%	50%	29%	49%	39%	40%

43% **Prospector**

"We are innovators and are willing to take the necessary risks of providing new products and services."

1st Generation	2nd – 4th Generation	5th+ Generation	Small	Medium	Large
49%	36%	71%	43%	44%	37%

6% **Analyser**

"We don't want to be first in our industry to offer unproven product or service, but we try to be close behind with a similar product or service that is competitive."

1st Generation	2nd – 4th Generation	5th+ Generation	Small	Medium	Large
5%	9%	0%	8%	11%	10%

8% **Reactor**

"We do not follow a specific program or plan for making us more competitive, although, when faced with strong threats, we definitely make changes."

1st Generation	2nd – 4th Generation	5th+ Generation	Small	Medium	Large
13%	5%	0%	0%	6%	13%

Competitive strategy

The main competitive business strategy used to achieve the family business objectives outlined previously was either a 'Defender[3]' type strategy (43 per of firms) or a 'Prospector' type strategy (also 43 percent of firms). Firms that follow a 'Defender' strategy focus on their existing products or services and attempt to protect their market share by offering superior product and service quality at a competitive price. Those that focus on a 'Prospector' strategy emphasise the development of new products and services through innovation and are willing to take the necessary risks to do so.

Eight percent of family businesses followed a 'Reactor' strategy indicating that they do not follow a specific program or plan for improving competitiveness, but when faced with strong threats, they make changes. The type of competitive strategy adopted is important as it was found to have a significant influence on the overall performance of a family business. Specifically, those that adopted a 'Prospector' strategy were significantly more likely to outperform other family businesses.

43%

use a 'Defender' or 'Prospector' type as their main competitive business strategy

Those that adopted a 'Prospector' strategy were significantly more likely to outperform other family businesses.

3. Miles, R.E. & Snow, C.C. (1978), *Organizational Strategy, Structure and Process*, New York: McGraw-Hill. Daily, M.C. & Dollinger, M.J. (1992), An Empirical Examination of Ownership Structure in Family and Professionally Managed Firms, *Family Business Review*, 5(2), pp. 117-136.

Compared to 1st generation family businesses, the 2nd – 4th generation family businesses were less likely to pursue a 'Prospector' strategy.

The main competitive business strategy adopted by family businesses varied according to their ownership and business lifecycles:

- **Generation in control** – with the exception of those firms that make it to the fifth or latter generation, as control passes from the first to second and later generations, family businesses were less likely to pursue a 'Prospector' strategy and more likely to pursue a 'Defender' strategy.
- **Firm growth** – as family businesses grow to become large in size, the less likely they were to adopt a 'Prospector' strategy and some were more likely to adopt a 'Reactor' strategy.

Given that the 'Prospector' strategy adopted was associated with high performing family businesses, it is important for family business leaders to be mindful of the effect that ownership and business transitions can have (as highlighted above) on the ability to maintain or adopt such a competitive strategy.

Characteristics of high performing family businesses

As discussed in Section 2 of this report, '*balancing the needs of the business vs. the family*' continues to be one of the enduring challenges that families in business face. Emphasis on business objectives to the exclusion of family objectives is likely to cause conflict, resentment and a weakening of family commitment to the business. Conversely, an emphasis on family objectives over that of the business is likely to undermine business performance and continuity. In their book titled '*When Family Businesses are Best*[4]', the well-known family business professors Randel Carlock and John Ward argue that family businesses perform best when the needs of both the family and the business are aligned and achieved. Below we identify the characteristics of family businesses surveyed that were able to achieve this balance.

Using data collected from this year's survey, we developed an overall measure of family business performance (FBP). This performance measure takes into account the importance that a firm places on different types of business goals (9 items) and family goals (9 items) and the extent to which the firm had achieved each of them. In essence, the higher the FBP score, the more successful the family business was in aligning and achieving their business goals and family goals (such as those identified previously). Further analysis was undertaken to identify the characteristics of family businesses that significantly outperformed others in their FBP score. The characteristics of these high performing family businesses are as follows:

CEO age: As CEOs age, firm performance increases. For example, firms with CEOs aged between 51 and 60 performed better than those with CEOs aged between 41 and 50. Firm performance was found to peak when CEOs were aged between 51 and 60. However, as CEOs approached 70 years of age and beyond, the relationship between CEO age and performance reversed. Firms with CEOs aged 70 years or older performed worse than any other CEO age group. It is generally recognised that our personal goals, propensity for risk-taking and cognitive ability, change as we age. For all family CEOs, there will come a time when it will be appropriate to pass on the leadership baton. As highlighted in Section 5 of this report, succession planning is essential to ensure that a suitable successor is appropriately prepared and that the CEO hands over the reins in a timely manner.

4. Carlock, R.S. & Ward, J.L. (2010), When Family Businesses are Best: The Parallel Planning Process for Family Harmony and Business Success, Palgrave Macmillan,

Diversity in leadership: High performing family businesses were more likely to (1) have a female CEO and (2) have a formal board of directors with a non-family, non-executive director. This suggests that gender and non-family diversity is important for leadership of a family business. Introducing diversity into the senior leadership team can assist in viewing issues from different perspectives and guard against 'groupthink'.

Communication: High performing family businesses utilise mechanisms that assist in the communication between the business, the family and the owners. These include the use of Family Constitutions, shareholder meetings/forums, shareholder agreements, and policies for selection, remuneration and promotion of family and non-family employees. They have also developed succession plans which document a unifying strategy for the future of the family in the business.

Outward focus: High performing family businesses utilise management techniques that focus on what is happening outside the business. These include benchmarking, competitor analysis, documented strategic plans (reviewed annually), and progress reports on strategic initiatives.

Entrepreneurial culture: High performing family businesses have developed an entrepreneurial culture within the business. Such a culture supports the pursuit of innovation to develop new products and services, proactively pursue opportunities and the willingness to take on key competitors. As a consequence, it is no surprise that firms that pursued a 'Prospector' strategy were more likely to outperform others. Conversely, those that pursued a 'Defender' or 'Reactor' strategy were significantly less likely to perform well compared to other family businesses.

Financial resources: It is fruitless for family businesses to implement an entrepreneurial culture unless they have the financial resources necessary to fund the associated competitive initiatives and strategies. As a consequence, family businesses which had greater access to financial resources were more likely to outperform others.

CHARACTERISTICS OF HIGH PERFORMING FAMILY BUSINESSES

- Have a **CEO** who is between **51 and 60 years of age**
- Have **diversity** in their leadership/governance team
- Utilise **governance** mechanisms that facilitate **agreement and communication** of expectations of the family, the business and shareholders
- Adopt business management practices that focus on what is happening **outside** the business
- Have an **entrepreneurial culture**
- Are able to access the **financial resources** necessary to implement their strategies

Section 2: Managing and resolving conflict

'Conflict is a natural part of human relationships, whether in a family or business setting. Conflict is neither positive nor negative; if handled correctly it leads to new thinking, better planning and decisions – and a stronger sense of trust and commitment' – Carlock and Ward, 2010.[5]

Over

80%

of family businesses had experienced conflict/tension between family members over the last 12 months

'Balancing the needs of the business vs. the family', 'family communication', and 'succession-related issues' are more likely to be sources of conflict as the business grows.

In this year's survey, over 80 percent of the family businesses surveyed indicated they had experienced conflict/tension between family members over the last 12 months (compared to 60 percent in the 2013 survey). The top five sources of conflict were issues surrounding the 'vision, goals and strategy' (i.e. future direction), 'balancing the needs of the business vs. the family', 'family communication', 'succession-related issues' and 'financial stress'. Interestingly, 'vision, goals and strategy' has consistently been the number one source of conflict within family businesses over the last three surveys (2011, 2013, 2015). Also, since this survey began in 2005, perhaps unsurprisingly, 'balancing the needs of the business vs. the family' continues to be one of the key challenges that families in business face. Compared to the 2013 survey, 'family communication' and 'succession-related issues' have been indicated as more prevalent sources of conflict within the family.

Further analysis of the results reveals that conflict is significantly influenced by the lifecycles of the family business. For example, 'balancing the needs of the business vs. the family', 'family communication', and 'succession-related issues' are more likely to be sources of conflict as the business grows. When the family business transitions from the first generation to latter generations (which may include sibling partnerships or cousin consortiums), they are more likely to encounter conflict over the future direction of the business (i.e. vision, goals and strategy) than first generation firms (which are predominantly owner/founder-led firms).

Even though this is to be expected, conflict is often viewed by family businesses and organisations generally, as something to avoid at all cost. As a consequence, issues underlying the conflict and tension persist, fostering distrust between family members, increased stress, breakdown in communication amongst the key decision-makers, and the inability of the business to adapt and change. Rather than trying to avoid conflict, it is important for business families to focus on identifying and discussing the underlying sources to develop workable responses that promote the well-being of both the family and the business.

5. Carlock, R.S. and Ward, J.L. (2010), When Family Businesses are Best: The Parallel Planning Process for Family Harmony and Business Success, Palgrave Macmillan, Hampshire, UK, p. 200.

MAJOR CAUSES OF CONFLICT

Major causes of conflict/tension (in order of most common)

2015	*2013*	*2011*	
1	1	1	Future visions, goals and strategy
2	n/a	n/a	Balancing needs of the family vs. business
3	6	4	Lack of family communication
4	8	3	Succession-related issues
5	5	n/a	Financial stress
6	3	n/a	Managing growth
7	2	n/a	How decisions are made
8	4	2	Competence of family in the business
9	9	5	Lack of family/non-family communication
10	7	6	Remuneration
11	10	7	Sibling rivalry

In the previous (2013) survey, around 50 percent of respondents indicated that formal or informal family gatherings were the most commonly used mechanisms by business families for discussing contentious issues. The next most common mechanism was a formal board of directors. Analysis of the 2015 survey data reveals that family businesses with a Family Council (i.e. formal family gatherings) were significantly less likely to have encountered conflict within the family within the last 12 months. A Family Council is a great arena for family members to raise and discuss issues which are of concern to them, as well as to clarify expectations they have of each other. This may include issues surrounding the equitable treatment of family members, dividend policy (family needs vs. capital requirements of the business), the future outlook of the business and potential opportunities for family involvement.

In many cases, the Family Council plays an important role in developing a Family Constitution. Put simply, a Family Constitution is a document which outlines the family's values and pre-agreed rules for how family members can participate and be recognised in the family business.

As the family business grows and is passed on to the second generation, there is likely to be a need to establish a Family Council and develop a Family Constitution. These strategies can assist family businesses to effectively manage their number one concern of having a shared vision and goals. However, given the changing nature of the wider economic and social context, it is crucial for family firms to ensure they embed a shared future vision in the firm to manage these changes.

Family businesses with a Family Council were significantly less likely to have encountered conflict within the family over the last 12 months.

Section 3: Technological change and future outlook

In this year's survey we examined the effect that technological change was having on family businesses. Over 50 percent of family businesses surveyed indicated that technological change was creating disruptions to the way that business is done in their industry.

Despite this, only 16 percent were very or extremely concerned about the effect of technological change on the future growth prospects of their business. Of particular interest is that family businesses overwhelmingly reported that such change was having a positive effect on their business. For example, around 90 percent reported that technological change was assisting them in how they manage their business and internal business processes, and enabled them to engage with their customers more effectively.

Around

90%

of family businesses reported that technological change was assisting them in how they manage their business and internal business processes, and enabled them to engage with their customers more effectively

80%

of family businesses reported that technological change was enabling them to better interact with their suppliers

"In the past I've struggled to compete with the bigger players in my industry with their big marketing budgets and market reach. However, the early adoption of social media technologies such as Facebook to market my business has enabled me to connect with new customers like never before. It has been such a leveller to competition; so much so that now I am growing at a faster rate than that of my largest competitor and will need to take on additional staff in the near future."

CEO, 2nd generation manufacturing company

Around 80 percent reported that technological change was enabling them to better interact with their suppliers, while around two thirds believed it was increasing the overall viability of their business model. Family businesses operating in the retail sector also reported that technological change was enabling them to expand into new geographical markets.

However, family businesses highlighted two main concerns regarding technological change. Firstly, over 20 percent indicated it was increasing the costs of doing business as they have to invest in staff and information technology as part of realising the benefits identified above. Secondly, technological change was increasing the intensity of competition experienced in their industry.

In a recent Harvard Business Review article[6], the authors argue that there will be no reprieve to the disruptions caused by technological change and globalisation. But in this uncertain future, there will also be no shortage of opportunities for businesses. The authors go on to argue that it is critical that business leaders self-impose disruption on their businesses before their key competitors do. Rather than being threatened by technological change, family businesses should constantly assess how they can embrace such change to adapt/improve their current (or develop a new) business model.

6. Dobbs, R., Koller, T. & Ramaswamy, S. (2015), The Future and How to Survive It, Harvard Business Review, October, pp. 48-62.

POSITIVE EFFECTS OF TECHNOLOGICAL CHANGE

Percentage of firms reporting positive effect of technological change

92%	The way we manage our business
91%	Internal business processes
90%	The way we interact with customers
79%	The way we interact with suppliers
66%	The viability of our current business model
64%	Costs of doing business
60%	Ability to expand into new markets
57%	Competitiveness of our products/services
51%	The level of competition in our industry
44%	Ability to expand into related industries

"The negative disruption and competitive impact of the digital world is not as dire as commonly believed. The general misconception is that print is dead and electronic products have taken over. As a successful family-owned print company we are fully aware of the technological disruptions to business and product. The market for print has shrunk but remaining in close contact with our clients has provided great digital opportunities rather than threats. We have chosen to embrace electronic communications as part of an intelligent and informed balance of strategic media tools. Print most certainly has a pivotal role."

General Manager, 2nd generation publishing company

It is no surprise that, as reported in Section 1, family businesses with an entrepreneurial culture were more likely to outperform others. Innovativeness, the willingness to take risks, delegate authority and proactively seek new ideas and opportunities are all important attributes for developing a sustainable competitive advantage, that technology can help to harness. The key challenge is how to sustain an entrepreneurial culture over the generations of family involvement. Two family business owners share their insights on how they have done this:

Family businesses with an entrepreneurial culture were more likely to outperform others.

"We have a young team all under the age of 35 in our product development team. We've fostered a safe to fail environment, enabling them to take risks, where nothing's off the table. They took the old school blinkers off and provided a different perspective to how we've been looking at it to create something very unique."

Chairman, 5th generation manufacturing company

78%

of the family businesses surveyed were optimistic about their future growth prospects

"Developing an entrepreneurial culture is essential as the only reason why we're not just surviving but thriving is because of our constant product and process innovation. Because family are more likely to take a long-term view to business and have more skin in the game, I think it's important to have a process for identifying and mentoring a family member (or members) with an entrepreneurial flair where they can be groomed to be the next generation of entrepreneurs. It's also important to develop a culture that is comfortable with constant change, and to clearly communicate why changes are required rather than what the changes will be. Ultimately, it's the tone at the top which is essential for building an entrepreneurial culture. We adopt an AIM philosophy (All Ideas Matter) where staff are encouraged to put forward new ways of doing things."

Managing Director, 2nd generation manufacturing company

70%

of family businesses indicated that they would need to invest in additional staff and/or assets in order to take advantage of future growth opportunities

Nearly 80 percent of the family businesses surveyed were optimistic about their future growth prospects. In fact, around 70 percent indicated that they would need to invest in additional staff and/or assets in order to take advantage of future growth opportunities. However, family businesses identified 'increasing costs of doing business' as the biggest threat to their future growth prospects:

"The volatile Aussie dollar, wage and rent increases would be the main threats to future growth. Unlike a key competitor in the USA which has experienced no growth in wage costs and a decline in factory rent costs over the last 10 years, our Sydney factory has had the burden of a minimum of 3% annual wage increase, and rents have gone up in accordance with CPI. We have to be realistic about what is happening in the rest of the world. America is devoting itself to getting back into manufacturing and getting their wages under control. Australia can't keep on putting wages up every year for the sake of putting them up. Another threat to our growth would be the lack of support from the banking industry for manufacturing. Currently, manufacturing is definitely not a favourite of the banks".

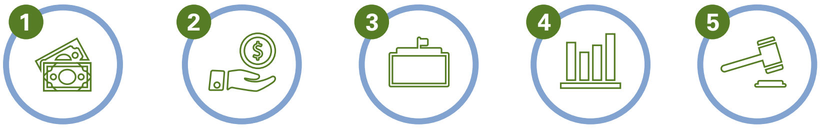
Chairman, 5th generation manufacturing company

The next four threats to growth prospects related to government policy and other factors beyond the control of family businesses (i.e. government's tax policies, response to current economic conditions and growing fiscal deficit, and compliance). As the general manager of a second generation building company highlighted, there are opportunities for the federal and state governments to work together to reduce unnecessary duplication of compliance requirements:

"Although we operate under a national building code, each state and territory requires the registration of the business as well as every individual contractor we use. That means if we operate in multiple states and territories, we have to complete multiple registration applications for multiple jurisdictions, often with different requirements. This impost on our business is unnecessary, expensive and consumes considerable valuable time that could be better spent on activities that add value."

General Manager, 2nd generation building services company

Top 5 threats to future growth prospects



1. Increasing costs of doing business
2. Increasing tax burden
3. Government response to current economic conditions
4. Government response to growing fiscal deficit
5. Over-regulation

In order to remain competitive and realise future growth opportunities, family businesses will need to focus their attention on strategies on how to improve their productivity. As highlighted by the managing director of a second generation manufacturer, embracing technological advances is one strategy for managing the threat of rising business costs:

> "Raw material, labour and electricity costs and state-based taxes have grown significantly in recent years. We don't have the ability to increase the price of our products to compensate for this so we have had to focus on improving productivity, predominantly through embracing technological advances. We now have machines that can produce three times the volume what machines could do 10 years ago. These days our key strategy is to work hand-in-hand with some of our machine suppliers to co-develop modifications to machinery to improve productivity, which we have the exclusive rights to."

Managing Director, 2nd generation manufacturing company

Section 4: Evolving governance mechanisms enhance performance

Results from this year's survey suggest that there is an increasing trend for family businesses to adopt formal governance mechanisms.

52%	of companies have a formal board of directors (compared to 39% in 2011)
51%	have a formal policy in place specifically for the selection, remuneration and promotion of family employees (26% in 2013)
43%	have a shareholders' agreement in place (36% in 2013)
31%	have a Family Constitution or code of conduct (compared to 20% in 2011)

There is also a greater inclination to keep a finger on the pulse of business progress with greater use of cash flow management reports, competitor analysis and regular monitoring of strategic progress – all strategies that can help a business identify and address problems promptly. There has been a significant increase in the number of small and medium-sized family businesses (<200 employees) adopting a Family Constitution and family code of conduct. We believe this is a further signal of the serious intent by family businesses in Australia to manage the number one source of conflict identified by firms, namely, to develop a shared vision about the future of the family business (direction, goals and strategies).

As highlighted in Section 1, analysis of the 2015 survey data suggests that adopting formal governance mechanisms can enhance family business performance. Specifically, high performing family businesses:

- had a formal board of directors with a non-family non-executive director
- adopted mechanisms that facilitated agreement and communication of expectations between the business, the family, and owners. These included adopting a Family Constitution, shareholder meetings/forums, shareholder agreements, and policies for both family and non-family employees, and a succession plan that documented a unifying strategy for the future of the family in the business
- used business management practices that focus on what is happening outside the business. These included benchmarking, competitor analysis, documented strategic plans (reviewed annually), and progress reports on strategic initiatives.

While the utilisation of effective and appropriate governance structures and practices is essential for the growing family enterprise, it is not a case of 'one size fits all.' The operative word here is 'appropriate' as with family businesses being at different stages of their development, there is no 'one right way' for governance mechanisms to be established. The important aspect is that governance can 'evolve' as the family business progresses through its business, ownership and family lifecycles, recognising that the **process** of evolution of governance is as important as the mechanism itself. For example, while not all firms will benefit from implementing a formal board of directors, establishing one will become increasingly important and valuable as they grow. This is evident in the 2015 survey results where 33 percent of small, 56 percent of medium, and 74 percent of large family businesses utilise a formal board of directors.

"The tipping point for our family businesses was that we had grown so big that we weren't able to confidently manage all the incredibly complex business issues... Establishing a formal board has had a massive positive effect on our business... from better management of our risks, a more professional culture, better responsiveness and terms from our bankers, to being more able to attract and retain high-calibre management."

Director, 2nd generation construction company

Similarly, family businesses are more likely to develop a Family Constitution as they transition from a founder-controlled business to a sibling partnership.

Issues such as the fear about losing control and privacy can dissuade a family business from formalising their approach to governance. However, with the increased complexity of the business enterprise and the increasing number of family stakeholders as ownership moves through the generations, the value of formalising governance is recognised. The trend indicated by respondents towards engaging family members in governance structures can be viewed as a strategy towards sustainability as a *family* business. Family businesses are complex entities but lying at the heart of family business is the family identity. While recognising the need to have good governance, the results suggest that engaging *family* in these governance mechanisms is also a way to preserve and protect the family's *identity* in the business.

Family businesses are more likely to develop a Family Constitution as they transition from a founder-controlled business to a sibling partnership.

Non-executive directors (NEDs)

As highlighted in Section 1, having the presence of a non-family non-executive director on the board was significantly associated with superior family business performance. This is consistent with studies in the family business literature which have encouraged family businesses to add non-family, non-executive directors to their boards, citing objectivity and broader horizons as the value for such appointments. Those that choose to appoint non-family NEDs may be signalling they need outside help because of the new circumstances they face and/or the need to improve the effectiveness of the board, and also a maturity and willingness to consider perspectives other than their own.

72%

of non-executive directors were family members

"Previously our board solely comprised of executive directors with an independent chairman. Often the chairman was the lone opposing voice to some proposals that the executive directors were particularly fond of. With the deteriorating health of my father, it was decided to appoint our first non-family NED with strong business acumen and governance experience to take the board to the next stage of development. Through introducing non-family NEDs, we have a more independent thinking, outside-looking-in type board which has been invaluable for the performance of our business."

Managing Director, 4th generation manufacturing & wholesale company

Despite the benefits of appointing non-family NEDs there has been a noticeable trend for family businesses to appoint NEDs from within (rather than outside) the family. In 2015, 72 percent of NEDs were family members which is significantly higher than that in 2011 (54 percent). There could be a number of reasons for this, including:

- a family member wanting to continue to have involvement with the business, transitioning from a day to day management role to a board position
- family members having a growing interest to participate in family business governance
- business families may be struggling to find suitable non-family NEDs.

"Trust is paramount… we found it difficult to find suitably qualified outside directors who we felt we could trust. Having a referral through a known source certainly helps. Once we get to know them better and there is a position on the board available, only then we will consider appointing them."

Managing Director, 4th generation manufacturing & wholesale company

"I feel there is a reluctance for business families to appoint non-family NEDs as they feel outsiders won't understand the way they operate, are more likely to trust family members over outsiders. They tend to be concerned with sharing confidential information with outsiders who may seek to 'meddle' with the family way of doing things."

Director, 2nd generation construction company

Another key role for a NED is one of mentoring the younger family directors, or indeed those who will potentially become directors. One strategy is to involve potential directors as observers on the board so they experience decision making approaches and debate. The development of family members for *ownership* responsibilities is as important as the usually recognised need for development of *leadership and management* responsibilities.

Family governance

As highlighted at the beginning of this section, adopting a Family Constitution, shareholder meetings/forums, shareholder agreements, and policies for both family and non-family employees significantly enhanced family business performance. Such mechanisms are critical for aligning the needs of both the family and the business, developing a unifying vision for the future and consequently maximising the performance potential of family businesses.

The increasing trend of family businesses to use a Family Council is encouraging because, as reported in Section 2 of this report, this mechanism was found to significantly decrease the likelihood of experiencing conflict between family members during the last 12 months. A Family Council is a great arena for family members to raise and discuss issues which are of concern to them, as well as to clarify expectations they have of each other. As stated by a second generation family CEO, it's invaluable to establish a functioning Family Council ahead of when it's desperately needed.

Adopting a Family Constitution, shareholder meetings/forums, shareholder agreements, and policies for both family and non-family employees significantly enhanced family business performance.

"I established a Family Council four years ago when I took over leadership of our family business. It was literally the first time my siblings had got together to talk about the business, who had little to no understanding about its activities. Although ownership succession was some time off, one of the first issues I raised at the Family Council was whether there was a future together in business or should we sell it off and go our separate ways? Being able to affirm the family's commitment to continue as a family in business together has given me greater clarity in my role as CEO, including what strategies to pursue and investments to make. The Family Council has also helped identify and work through issues that family members have very different view on, issues that were initially thought to be fairly straight forward."

CEO, 2nd generation whole and retail company

In summary, while the trend to formalise governance is obvious, there is a need to continually examine how performance of the various governance mechanisms can be made even more effective. There needs to be clarity of board roles, particularly where two hats might be worn by some directors (a family hat and a business hat) and there might well be a place for formalising the evaluation of board performance.

FAMILY GOVERNANCE MECHANISMS/BUSINESS STRUCTURES AND PRACTICES

	2015	2015 Breakdown by firm size		
	All firms	Small	Medium	Large
	Yes	Yes	Yes	Yes
Governance positions				
% executive directors that are family members	89%	98%	89%	78%
% of non-exec directors that are family members	72%	96%	80%	32%
Business governance structures/practices				
Formal board of directors	52%	33%	56%	74%
Formal advisory board (regular meetings with a selected ongoing group of advisors)	28%	25%	28%	33%
Informal advisory board (adhoc meetings with advisors)	89%	83%	93%	87%
Shareholders' agreement	43%	30%	51%	48%
A policy for the selection, remuneration and promotion of family employees	51%	41%	54%	61%
A policy for the selection, remuneration and promotion of non-family employees	36%	24%	45%	37%
Communication practices				
Formal reporting to all shareholders about business matters (e.g. through reports and shareholders' meetings)	39%	32%	39%	53%
Business management reports				
Documented strategic/ business plan	78%	70%	77%	94%
Documented budget for the financial year	90%	80%	94%	97%
Regular income/expenditure reports (> once per year)	91%	85%	93%	97%
Benchmarking performance against other businesses	58%	49%	61%	66%
Cash flow management report	92%	87%	93%	97%
Competitor analysis	60%	53%	59%	78%
Progress reports on strategic initatives (defined in strategic plan)	69%	57%	72%	81%
Family governance structures/practices				
Family Council (family members that represent the family to the business)	38%	42%	36%	39%
A Family Constitution or code of conduct	31%	23%	31%	44%

Section 5: Preparing for leadership and ownership transitions

Characteristics of family business CEOs

The most senior decision-makers (referred to as the CEO in this report) within the family businesses sampled were predominantly family members (93 percent), male (85 percent) with a median age between 51 and 60 years. Over 50 percent had university qualifications and on average had been in this role for 16 years.

Gender diversity

The number of female CEOs was only 15 percent, down from 23 percent in the 2013 survey and almost the same as that in 2011 (14 percent). Research shows that diversity in teams can foster both innovation and team success. Family businesses have the opportunity to build diversity in their management teams using the valuable resources available in their next generation, but also drawing on their current resource base, for instance, promoting more women in managerial positions. The fact is family businesses can benefit from building and supporting an entrepreneurial culture. Managing human resources is a key to achieving this objective. Crafting diversity management approaches that foster high performance workforces is the challenge facing family businesses in a future where diversity characteristics such as culture, age, and gender will inevitably characterise their workforce.

15%

of family business CEOs were female

The median age of family business CEOs is between

51-60

years old

The performance of family businesses peaked when CEOs were aged between 51 and 60.

When to pass the baton?

It is generally accepted that one of the competitive advantages of a family business is its long-term perspective; decisions are made with the future in mind rather than for short-term shareholder gain which we hear so often of the corporate sector. In family businesses, family managers and CEOs are more likely to have longer tenure than non-family CEOs. It is recognised that once in the family business, incumbents remain ‘for life’ (formally or informally). This long-term perspective has some great advantages but there are also some potential down sides.

An interesting finding from this survey is that the performance of family businesses peaked when CEOs were aged between 51 and 60 and declined as CEOs approached 70 years of age and beyond. We can only speculate on why this might be although it is generally recognised that as we age our personal goals, cognitive ability and risk profile changes.

76%

of family businesses expected to appoint a new CEO in the next 5 years

Regardless of age, leaders need to continually self-assess their performance and evaluate whether they possess the skills and the cognitive ability to adapt to the fast moving pace organisations needs to operate in. They also may need to consider adapting their leadership style to that required to address upcoming business, ownership and/or family lifecycle transitions.

This finding reinforces what we have known for some time, namely, that the timeliness in which the business is handed over is a key differentiator for a family businesses performance metrics. What is the tipping point? What alternative roles can we offer to retirees to harness their experience for the good of the family and the business? Or, given the reality of our ageing society, family businesses – like other businesses – must accept the challenge of ensuring policies and practices are in place that can support these valuable human resources to achieve their potential.

Some options that can be explored are variation to work time, strategically composed teams, opportunities for renewal, and of course continuous training and upskilling. An important component of the succession process is ensuring the incumbent has a meaningful role and purpose in his or her retirement, i.e. that he or she is retiring 'to' something, rather than 'from' something. Conducting a needs and resources analysis would be a key step forward that family businesses can take in identifying their next steps. By asking questions such as 'what does our business need', 'what does our business have to meet that need', family businesses can begin to become more knowledgeable about the plusses and minuses of the human resources in their firm – and begin to plan for what they need.

Leadership intentions

With regard to future leadership intentions, 24 percent of family businesses had no management transition strategy in place, most likely because their CEOs were less than 60 years of age and intended to continue on in the role for the foreseeable future. The remaining 76 percent of firms expected to appoint a new CEO in the next 5 years and suggests that for the majority of family businesses, significant leadership changes are on the horizon. Further analysis of these firms revealed that:

60%

intended to pass on the CEO role to a family member

(10% to the current generation, 50% to the next generation) within the next 5 years.

30%

intend to pass on the CEO role to a non-family member

(18% to a non-family member who currently work in the business, 12% to a non-family member from outside the business).

10%

intend to sell the business in the next 5 years

Overwhelmingly, this suggests that most family businesses intend to keep the CEO role in family hands. Survey respondents who indicated an intention to pass on the CEO role to a family member in the next 5 years (the 60 percent referred to above) were also asked whether they believed the likely family successor was prepared and ready to take over.

26%

of those intending to pass on the CEO role in the next **12 months** believed the likely successor was NOT ready

55%

of those intending to pass on the CEO role in the next **2–3 years** believed the likely successor was NOT ready

63%

of those intending to pass on the CEO role in the next **4–5 years** believed the likely successor was NOT ready

It is of particular concern that 55 percent of family businesses do not believe that the likely family successor is ready to take over in the next 2–3 year timeframe. Respondents indicated that this lack of readiness related to three key skill sets: 'financial management', 'strategic planning' and 'leading and managing people'. For those who might be handed the leadership baton in within 12 months, sales and marketing skills were also considered in need of further development. Further analysis reveals that a lack of succession planning could be a contributing factor to this problem as only a quarter of these firms had a documented plan in place to prepare and train the likely successor (for example in the above skill sets) before the management transition takes place.

CEOs believe their potential successor needs to work on:

1. Financial management
2. Strategic planning
3. Leading/managing people

Ownership intentions

With regard to changes to ownership in the future, 28 percent had no ownership transition strategy in place, most likely because the CEOs were less than 60 years of age and intended to continue on with the existing ownership structure for the foreseeable future. The remaining 72 percent expected to have some transfer of ownership in the next 5 years. Further analysis of these firms revealed that:

- 64 percent intended to pass on ownership solely to family members and thereby keeping the business wholly family-owned
- 10 percent intend to sell a minority share of the ownership to non-family/outsiders
- 6 percent intend to sell a majority share of the ownership to non-family/outsiders
- 20 percent intend on either closing the business (liquidating assets) or selling the business entirely.

Overwhelmingly, this suggests that most family businesses will undergo some form of ownership change in the next 5 years.

72%

of family businesses expected to have some transfer of ownership in the next 5 years

Family businesses with documented retirement plans for the current CEO are significantly less likely to experience conflict.

High performing family businesses were found to have a succession plan that documented a unifying strategy for the future of the family in the business.

Preparation for upcoming transitions

As is readily accepted, one of the key challenges for family businesses is the smooth transition from one generation to the next, for both management and ownership succession. Clearly, a key strategic response to the leadership and ownership changes intended to occur over the next 5 years is to develop and document a comprehensive succession plan. Consistent with prior research, the respondents regrettably self-report as being ill-prepared for exit/succession. Specifically, only:

- 27 percent have a documented unifying strategy for the future of the business
- 9 percent have a documented retirement plan for the current CEO
- 14 percent have a documented plan for preparing and training a successor before succession
- 12 percent have a documented process for appointing a new CEO
- 21 percent have a documented ownership transfer or sale plan
- 42 percent have a documented estate plan.

The good news is that despite the above statistics, a greater percentage of family businesses are prepared for succession compared to last time this survey was conducted (2013). As highlighted earlier in this report, there are many advantages in developing and documenting a comprehensive succession plan. For example, family businesses with documented retirement plans for the current CEO are significantly less likely to experience conflict. Also, high performing family businesses were found to have a succession plan that documented a unifying strategy for the future of the family in the business. An important component of any 'documentation' of plans is often the process of consultation and airing of views that occurs in undertaking such documentation rather than the outcome of the plan itself. Plans can then address the expectations of the range of stakeholders and accordingly, the consultations will invariably reduce the likelihood of future conflict.

Breaking down the results by CEO age group reveals some interesting insights. For example, the older the CEO, the less likely the family business is to have a documented unifying strategy for the future of the business. The 31–40 CEO age group leads other age groups with regard to documented strategy, ownership transfer/sale plan and estate plans (except for the 70+ group for ownership and estate plans which is understandable). Our view is that the younger CEOs are more open to working 'on' the family business which contributes to its professionalisation. We know from other research that the younger CEOs are more likely to have undergone formal education and may therefore be more comfortable with the forward consideration of business needs and developing formal plans to address them.

COMPONENT OF SUCCESSION PLAN

	No plan		Under development		Documented Plan	
	2015	2013	2015	2013	2015	2013
A unifying strategy for the future of the business	30%	36%	43%	45%	27%	19%
Retirement plan for current CEOMD	50%	41%	41%	50%	9%	9%
Preparing and training a successor before succession	42%	37%	44%	52%	14%	12%
Process for appointing new CEOMD	53%	55%	35%	38%	12%	8%
Ownership transfer or sale plan	46%	58%	32%	32%	21%	10%
Estate plans	30%	35%	28%	35%	42%	30%

CASE STUDY: GARRY BEARD – CHAIRMAN, A. H. BEARD

A.H. Beard is one of Australia's leading manufacturers of quality mattresses and bedding. As a 5th generation family-owned Australian business, A.H. Beard has built a reputation as innovators in sleep products. Chairman, Garry Beard spoke with us about their success.

How do you foster an innovative culture?

We've created a 'safe to fail' environment throughout the company, and a great example is in our product development team. The team are all aged under 35 and are empowered to take risks, nothing's off the table. They came up with the design concept for a new spring support system (Reflex) which has now been rolled out across Australia and into China. In the past we would have waited for the spring specialists of the world (USA, Germany) to come to us with a spring unit. They took the 'old school blinkers' off and brought new thinking to the creation of spring systems. How does that translate to business benefit? It has given us recognition in the international playing field of the bedding industry.

How has being a family business helped with your success?

Our success is very much built on our collective vision being shared by everyone in the business from the docks and factories, right through to the front line sales people. I believe we get the support because we are a family business, both here in Australia and with our entry into China.

Being a 5th generation family business has greatly helped our entry and success in the Chinese market. In 2012 we were approached by two Chinese business women who had searched the internet for credible suppliers of quality bedding for import into the high end bedding market. Three years later we are now supplying 35 shops and expect to double that by the end of next year.

In China there are 1,700 bedding manufacturers, all mass producing beds selling for up to $1,000 without a focus on quality. The Chinese customers we deal with have extremely high expectations, they expect the highest quality and are willing to pay up to US$76,000 for Australian hand-made mattresses. To meet this demand, we brought back two gentlemen who had started with as apprentices and worked for us for 40 years. They've trained our younger people to make beds by hand like we made them 40–50 years ago and because of the quality and the hand mastercraft, together with highest quality natural fibres, our Chinese customers recognise the beds as extremely good value.

We demonstrated the importance of family legacy when we opened our first (and second) shop in China, by taking the family shareholders – myself, my brother and my two sisters, together with former Prime Minister John Howard and his wife Jeanette.

How are you using technology to interact with customers?

In 2013 we digitally launched the AH Beard 6 week sleep challenge, designed to help Australians get a better night's sleep. We now have 40,000 followers. It's not about selling our beds, it's purely about improving lives through better sleep. We have partnered with the *Sleep Health Foundation* and leading sleep scientist Dr Carmel Harrington to develop a program that builds good sleep habits. Our users can receive expert advice through the blog and support from an online community. Our Chinese partners have now seen it and will be rolling it out in China.

How does A H Beard ensure they are keeping up in this rapidly changing business environment, both locally and globally?

We have appointed a General Manager, Exports. He is an Australian who speaks fluent Mandarin and was educated at the University of Shanghai. He is championing our exports to bigger things. Having a senior team member with an understanding of the Chinese culture and market has been invaluable to our growth in China.

Secondly, by the end of fiscal year 2015, we will have spent over $10m across our plants in New Zealand, New South Wales and Victoria, updating them to the best machinery available, to allow us to be the most efficient bedding plant we can be, to satisfy our markets. We work on a just-in-time model, whereby across Australia we maintain order in and out the door within 5 days.

And finally, our (non-family) CEO is very attuned to what's going on globally, and this covers new connections we are developing to licence our brand in Russia and USA. Keeping pace on an international level with what's going on in the 'bedding game' and constantly re-visiting our vision to ensure we are on track.

A.H.BEARD®
Improving Lives Through Better Sleep.

Australia: ahbeard.com.au
China: ahbeard.com.cn
Facebook: facebook.com/ahbeardbeds

About the survey

This report is the result of the combined efforts of Family Business Australia, KPMG and the University of Adelaide's Family Business Education and Research Group (FBERG), with the assistance of others including Dr Donella Caspersz from the University of Western Australia. In June, 2015, a fifty-three item questionnaire, covering a range of different family business-relevant themes, was distributed to 1,700 family businesses listed on KPMG Australia's and Family Business Australia's databases. The survey was distributed to the CEO of each firm who completed either a paper-based or online version, and resulted in an overall response rate of 12 percent.

Dr. Jill Thomas and Dr. Chris Graves, from FBERG, undertook the analysis of the responses received which was further explored through focus groups and interviews of family business owners in Adelaide, Brisbane, Melbourne and Sydney.

The median age of the firms sampled was 37 years, 84 percent were small to medium-sized enterprises with median sales revenue between $10 million and $20 million. Approximately 20 percent were operated through trusts while 75 percent were proprietary companies. Although all industries and regions of Australia were represented, most of the respondents came from the construction, manufacturing and retail trade in Victoria, New South Wales, South Australia and Queensland. The majority (almost 60 percent) of respondents were 2nd or later generation controlled family businesses.

Firm size	2015
Small (1-19 employees)	36%
Medium (20-199 employees)	48%
Large (200+ employees)	16%

Firm size (Sales $)	2015
Less than $500K	2%
Between $500K and $1M	7%
Between $1M and $2M	5%
Between $2M and $5M	15%
Between $5M and $10M	15%
Between $10M and $20M	15%
Between $20M and $50M	19%
Between $50M and $100M	7%
Between $100M and $200M	7%
More than $200M	8%

Industry	2015
Agriculture forestry fishing and hunting	6%
Business consulting scientific and technical services	3%
Construction	13%
Cultural and recreational services	1%
Education and training	0%
Electricity gas and water and waste services	2%
Financing insurance and superannuation services	4%
Health care and community services	1%
Hospitality hotels cafes restaurants accommodation	3%
Information media publishing telecommunication services	1%
Manufacturing	15%
Mining	3%
Rental hiring and property services	6%
Retail trade	15%
Support services	3%
Transport postal and storage services	8%
Wholesale trade	8%
Other	8%

Generation in control	2015
1st generation	41%
2nd generation	39%
3rd generation	12%
4th generation	4%
5th+ generation	4%

Legal structure	2015
Partnership	5%
Private Company Pty Ltd	75%
Public Company Ltd	1%
Trust	19%

Location of businesses by state	2015
Australian Capital Territory	1%
New South Wales	23%
Northern Territory	3%
Queensland	15%
South Australia	21%
Tasmania	3%
Victoria	25%
Western Australia	9%

Contact us

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

Rob Bazzani
National Leader,
KPMG Private Enterprise
+61 3 9288 5594
rbazzani@kpmg.com.au

Adelaide
Ashley Miller
+61 8 8236 3316
amiller1@kpmg.com.au

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

Darwin
Denys Stedman
+61 8 8982 9002
dstedman@kpmg.com.au

Gold Coast
Aaron Street
+61 7 3233 3138
astreet@kpmg.com.au

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

Launceston
Michael Hine
+61 3 6337 3721
mhine@kpmg.com.au

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

Parramatta
David Pring
+61 2 9455 9996
davidpring@kpmg.com.au

Perth
Agnes Vacca
+61 8 9263 7211
avacca@kpmg.com.au

Sydney
Leanne Hegarty
+61 2 9335 7397
lhegarty@kpmg.com.au

Wollongong
Warwick Shanks
+61 2 4231 5355
wshanks@kpmg.com.au

kpmg.com/au/familybusiness

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 The University of Adelaide's Family Business Education and Research Group (FBERG), please contact:

Dr Chris Graves
Co-Founder, FBERG
The University of Adelaide Business School
+61 8 8313 7108
chris.graves@adelaide.edu.au

Dr Jill Thomas
Co-Founder, FBERG
The University of Adelaide Business School
+61 8 8313 4911
jill.thomas@adelaide.edu.au

www.business.adelaide.edu.au/research/fberg