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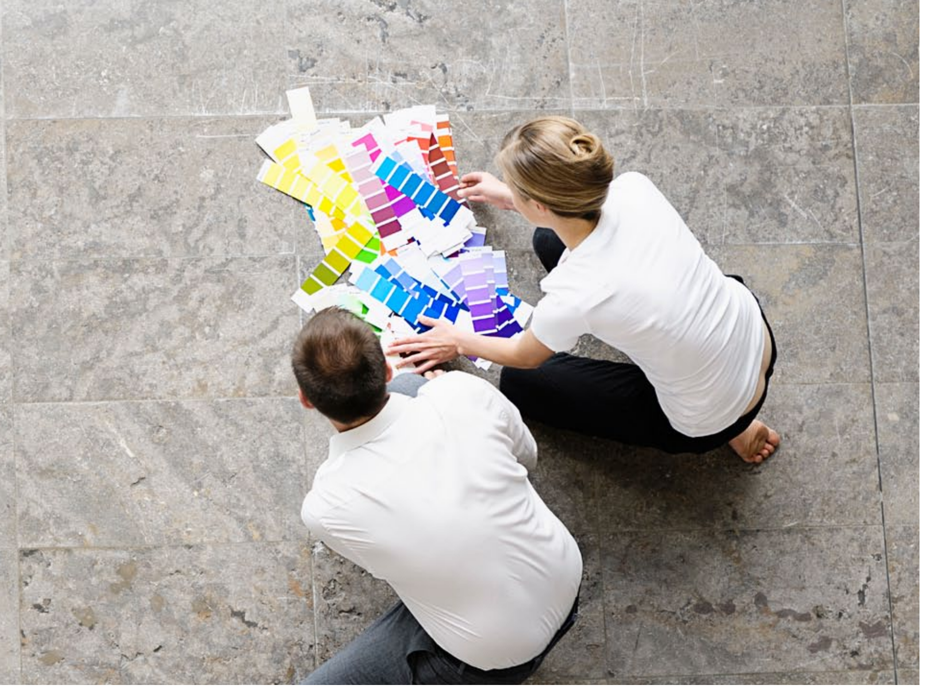
Enduring across generations



How a governing structure drives value in family-owned businesses

By: ***Xiaonan Sun***, *Manager | KPMG Advisory*

Introduction

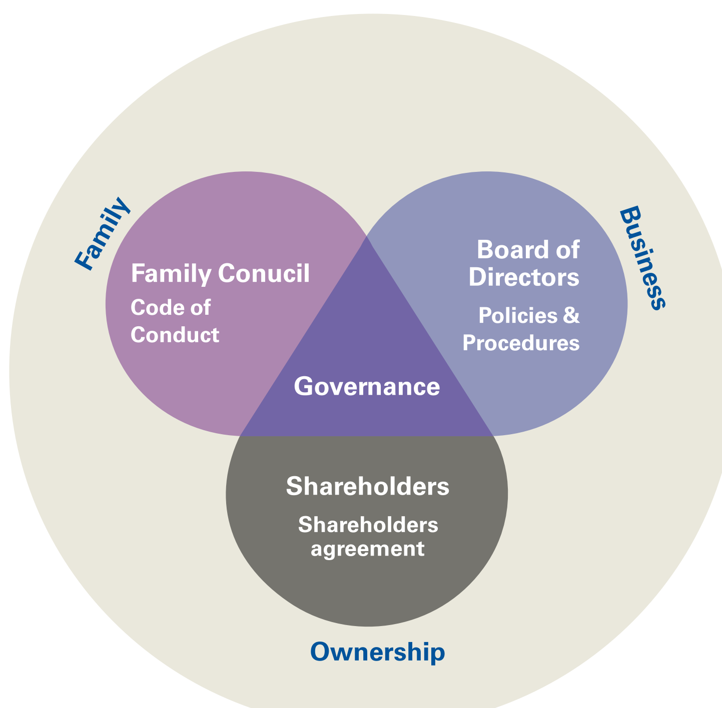
Vision. Passion. Single-minded focus and dedication. There is nothing quite like the entrepreneurial spirit that sparks the launch and spurs the growth of a family business. The combination of performance, profit and family pride can be a powerful force in driving founders and owners to build great businesses and valued brands. But family businesses that endure across generations tend to have an added edge: great governance.

Strong governance plays a critical role in positioning a family business for the future. From helping to define and calibrate the strategy, grooming future leaders, and navigating (often thorny) family dynamics, to bring independent perspectives into the boardroom dialogue, an effective board can be an invaluable asset to the business.

Drawing on KPMG's experiences working with hundreds of family businesses around the world, this article brings together a body of practical suggestions and insights into building and leveraging a high-performance board.

The Benefits of Governance

Based on our experience, governance becomes vital to a family business as it grows and confronts new opportunities, challenges, and critical questions about its future direction. The growth and sustainability of a family business lies in the fine balance between the needs of the business and the expectations of family members. Family, business and ownership are the three pillars of a family-owned business as illustrated below.



In this issue

Effective governance of a family business can help improve the company's performance and satisfy the expectations of family members. Governance is a broad term that can encompass many aspects relevant to the running of a business, in short, it determines how decisions will be made, and establishes checks and balances. A central element of corporate governance is the role of the board.

There are family businesses that survive and even thrive across generations without boards or independent directors. However, in practice, these are the exceptions rather than the rule. A board that includes independent directors can add value to strategic planning, succession and execution, by bringing in new ideas, spurring innovation, and helping the owners make necessary, tough decisions. This perspective is consistent with the findings of a study conducted in the US of more than 80 family businesses run by the third or later generations that, as reference in the International Financial Corporation's (IFC) Family Business Governance Handbook: "showed that the existence of an active and outside board was the most critical element in the survival and success of these companies."

Boards and directors are not all the same. All family businesses, whether successful or struggling, face different challenges, and their boards are shaped by different factors, including:

- The legal and regulatory obligations – which may range from a highly regulated environment to no applicable law at all, depending on the industry in which it operates.
- The company's ownership structure – which may range from a business closely held by a few family members who see each other on a daily basis, to one with numerous, geographically dispersed distant family members, to inclusion of other investors, either through private equity investment or publicly traded stock.
- The expectations and interests of key stakeholders including owners, other interested family members (such as the owners' likely heirs), customers and financiers.
- The company's attributes – size, resource, maturity, culture and level of complexity.

Each family business is unique, and of course its needs will change over time. The key is to have the family, the stockholders, and the business well-coordinated. It is clear that family businesses with effective governance, including a board that brings experience, insight and objectivity to the table, are far better positioned to not only survive, but also thrive across generations.

The Three Enablers: Clarity, Culture, Communication

A family business may choose any one of a number of governance models such as an all-family board, a partially independent board, or an independent board, or even an advisory board. Whichever style of board is used, three elements serve as enabling forces:

1. Clarity of roles, responsibilities, and how decisions are made;
2. An understanding of the culture - the vision and values-and how that impacts decision making and implementation;
3. Communication – transparency and information flow that enables the board to fully understand the challenges and opportunities facing the business and add real value as the company refines its strategy, grooms new leaders, and continues to grow.

Clarity: Roles and responsibilities

In a family business, there are family members, there are owners, there are members of management, and there is a board. In small businesses, these roles are likely to be filled by the same people, and decisions ranging from geographic expansion to estate planning to family vacation plans move fluidly. However, businesses that endure across generations eventually grow to a point where they can no longer operate that way. In family businesses, things tend to get a little bit fuzzy sometimes. Directors need to know what decisions they can make and which ones must be made by the shareholders.

- **Family:** when the family grows large enough, a family council can be helpful. The family council may help the family preserve wealth through a family office that provides investment advice and estate planning; it may coordinate family philanthropy; and plan family gatherings. The family council can also be a good forum for developing policies regarding employment of family members. It should be clear, however, that the council is providing input and recommendations on this subject rather than making final decisions.

- **Owners:** the family council group and the owners group will usually have significant overlap in membership, however, they may not be identical for various reasons. Extra care may be needed to avoid the frequent confusion that arises between the role of the family council and the role of the owners. Making decisions about the company are the purview of the board and not the family council. It is the owners who elect the board and approve major decisions.
- **Board:** the board governs the business on behalf of the owners. Boards operate through committees as well as through the full board.
- **Management:** runs the company under the leadership of the CEO who reports to the board and/or owners.

Surprisingly, even some large, established private companies with strong governance and an independent board, operate through an "unwritten sense of the board". Written charters for the board and its committees not only help new members understand their role. The process of putting it on paper can also benefit long-time stakeholders by bringing to light differences in assumptions, ambiguities, or lack of clarity in important areas that would not otherwise be apparent. Once written, charters are useful as an annual check in to confirm that the board has done what is expected of it, and to determine whether the roles and responsibilities need updating in light of changes in the business environment.

Culture: vision and values

Family businesses tend to have a long term vision and a deep sense of responsibility to, and pride in the company that often bears the family name.

A strong vision and commitment to operating in a responsible manner can serve as a foundation when recruiting talent, from junior positions all the way up to the board, and informed decision making at every level. Family members who have grown up steeped in the company's values may take them for granted and assume that every company operates in the same way. Independent directors may be able to help the business view the vision and values through an external lens, to ensure that the company is communicating and leveraging them to full advantage.

Communication: Transparency

The more information directors have access to, the more valuable their perspective and guidance can be. All boards, including those of large public companies, often face the inherent challenge of "information asymmetry" i.e. the people running the company know more about it than outside directors.

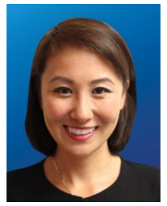
Adding to the information asymmetry faced by independent directors at all companies, when it comes to family business, family members may desire to keep certain matters that are normally the purview of the board – such as executive compensation, succession considerations, or even business challenges within the family. Extra care taken to build and maintain trust that the information will remain confidential and not be misused, may help independent directors gain access to important information over time as the family becomes comfortable with sharing sensitive information with the board.

Conclusion

Governance provides an edge for family businesses – roles are clear; decisions are made objectively; and the various stakeholders work together to ensure healthy growth of the business over the long term. Solid governance rests on a foundation of clear roles and responsibilities, an organisation in which there is a strong culture, with alignment of the company's vision and deeply held values, as well as open communication.

Of course, every family business is unique, but the insights built on other families' success, and more importantly lessons learned from mistakes, can go a long way toward helping your family business tap into the full value of the board, and position the company to thrive and endure across generations.

For further information on this article, please do not hesitate to contact:



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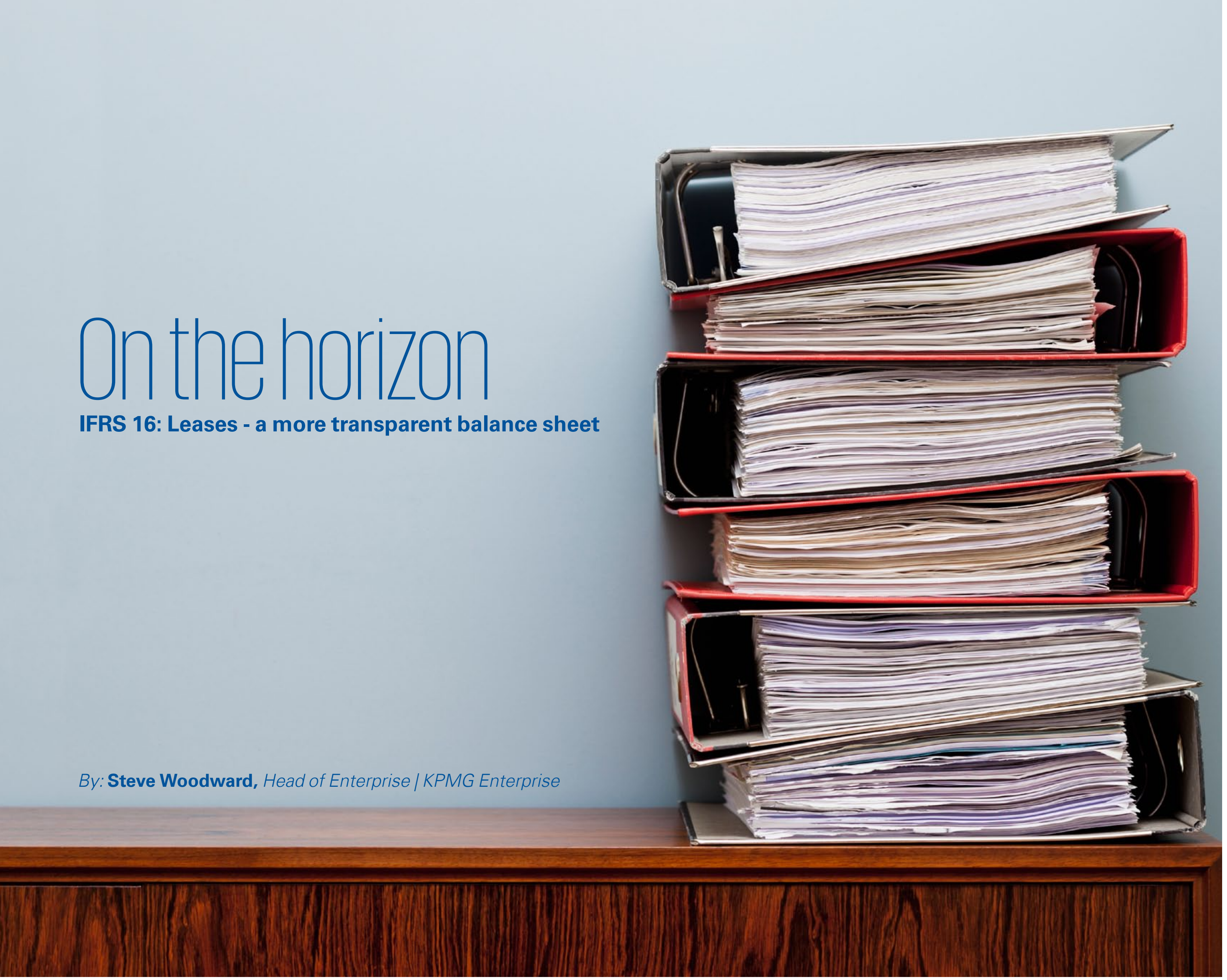

On the horizon

IFRS 16: Leases - a more transparent balance sheet

By: ***Steve Woodward,*** *Head of Enterprise | KPMG Enterprise*

The International Accounting Standards Board's (IASB) new leases standard requires companies to bring most leases on-balance sheet, recognising new assets and liabilities.

In January 2016, the IASB issued International Financial Reporting Standard (IFRS) 16 Leases – realising its long-standing goal of bringing leases on-balance sheet for lessees. All companies that lease major assets for use in their business will see an increase in reported assets and liabilities. This will affect a wide variety of sectors, from airlines that lease aircraft to retailers that lease stores. The larger the lease portfolio, the greater the impact on key metrics.

Companies are currently required to disclose details of their off-balance sheet leases and many analysts use this information to adjust published financial statements. The key change will be the increase in transparency and comparability. For the first time, analysts will be able to see a company's own assessment of its lease liabilities, calculated using a prescribed methodology that all companies reporting under IFRS will be required to follow.

The impacts are not limited to the balance sheet. There are also changes in accounting over the life of the lease. In particular, companies will now recognise a front-loaded pattern of expense for most leases, even when they pay constant annual rentals. And the standard introduces a stark dividing line between leases and service contracts - leases will be brought on-balance sheet, whereas service contracts will remain off-balance sheet.

IFRS 16 at a glance

Topic	IFRS 16
Lessee accounting model	• Single lease accounting model • No lease classification test • All leases on-balance sheet: ▪ lessee recognises a right-of-use (ROU) asset and lease liability ▪ treated as the purchase of an asset on a financed basis
Lessor accounting model	• Dual lease accounting model for lessors • Lease classification test based on International Accounting Standards (IAS) 17 classification criteria • Finance lease accounting model based on IAS 17 finance lease accounting, with recognition of net investment in lease comprising lease receivables and residual assets • Operating lease accounting model based on IAS 17 operating lease accounting
Practical expedients and targeted reliefs	• Optional lessee exemption for short-term leases – i.e. leases for which the lease term as determined under the new standard is 12 months or less • Portfolio-level accounting permitted if it does not differ materially from applying the requirements to individual leases • Optional lessee exemption for leases of low-value items - i.e. assets with a value of USD 5,000 or less when they are new - even if they are material in aggregate
Effective date	• Accounting periods beginning on or after January 1, 2019 • Early adoption is permitted if IFRS 15 Revenue from Contracts with Customers is also adopted.

The new standard takes effect in January 2019. Before that, companies will need to gather significant additional data about their leases, and make new estimates and calculations. The new requirements are less complex and less costly to apply than the IASB's earlier proposals. However, there will still be a compliance cost. For some companies, a key challenge will be gathering the required data. For others, more judgmental issues will dominate – e.g. identifying which transactions contain leases.

Key impacts

Identifying all lease agreements and extracting lease data. Lessees will now recognise most leases on-balance sheet. This may require a substantial effort to identify all lease agreements and extract all relevant lease data necessary to apply the standard. To apply the simplified model for short-term leases and leases of low-value items, a company will need to identify the lease and extract key lease terms.

Changes in key financial metrics. Key financial metrics will be affected by the recognition of the new assets and liabilities, and differences in the timing and classification of the lease income/expense. This could impact debt covenants, tax balances and a company's ability to pay dividends.

New estimates and judgements. The standard introduces new estimates and judgemental thresholds that affect the identification, classification and measurement of lease transactions. Senior staff will need to be involved in these decisions – both at lease commencement and at reporting dates as a result of the continuous reassessment requirements.

Balance sheet volatility. The new standard introduces volatility to assets and liabilities for lessees, due to the requirements to reassess certain key estimates and judgements at each reporting date. This may impact a company's ability to accurately predict and forecast results.

Changes in contract terms and business practices. To minimise the impact of the standard, some companies may wish to reconsider certain contract terms and business practices – e.g. changes in the structuring or pricing of a transaction, including lease length and renewal options. The standard is therefore likely to affect departments beyond financial reporting – including treasury, tax, legal, procurement, real estate, budgeting, sales, internal audit and IT.

New systems and processes. Systems and process changes may be required to capture the data necessary to comply with the new requirements, including creating an inventory of all leases on transition. The complexity, judgements and continuous reassessment requirements may require additional resources and controls focused on monitoring lease activity throughout the life of leases.

Some impacts cannot yet be quantified. Companies won't have the full picture until other accounting and regulatory bodies have responded. For example, the new accounting could prompt changes in the tax treatment of leases. And a key question for the financial sector is how the prudential regulators will treat the new assets and liabilities for regulatory capital purposes.

Transition considerations. A key early decision is how to make the transition to the new standard. For many companies, the choice of transition method and which practical expedients to apply will have a major impact on the cost of implementing the standard and the comparability of the trend data in the years after transition.

Communication with stakeholders will require careful consideration. Investors and other stakeholders will want to understand the standard's impact on the business. Areas of interest may include the effect on the financial results, the costs of implementation and any proposed changes to business practices.

The new standard includes specific guidance on other lease accounting topics that is generally more detailed and prescriptive than existing requirements. These topics include:

- Sale and lease back transactions;
- Sub-leases;
- Investment property; and
- Lease modifications.

The new standard also increases the disclosure burden for lessors and lesses in comaprison to IAS 17, requiring information that provides a basis of financial statement to assess the effects on financial position, financial performance and cash flow.

For further information on this article, or a copy of KPMG's detailed guidance on IFRS 16, please do not hesitate to contact:

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Next steps

Read the new standard

Think about your implementation plan

Watch our for our detailed analysis at kpmg.com/ifrs

A start-up's guide to being brilliant at social media

Social media should be in the armoury of pretty much any entrepreneur, and that includes brand new ones.

*By: **Chris Eaton**, Senior Manager | KPMG Advisory*

Start early

Do not assume that you need to have fully launched your business to start using social media. If you build up a community of followers on Twitter, Facebook, Instagram, LinkedIn and elsewhere, when you do go live with your product or service you'll already have potential customers ready to buy.

Start small with, for example, a Twitter or Facebook account that shares content related to your planned business and have conversations with interested parties. You could also use your social account to share your start-up journey. Post images of your efforts to design a logo, your new office, visits to small business events etc. This will build a story around your brand and allow people to buy in to your vision.

Even if your products or services are not ready, start a simple blog and share content from that on social media. Offer followers something such as a free download or a money off voucher in return for their email address. You'll then launch your new business with a mailing list ready.

It's good to talk

This would not be a proper social media article without the phrase "it's all about conversation", but it really is true. You should not spend your whole time on social media banging on about you and your business. You must have conversations if you truly want to make the most of it.

One advantage that start-up founders and small business owners have over large companies is that they are the business and aren't bound by legal departments and corporate bureaucracy. You can talk directly to your customers and build a relationship. Equally, if things go wrong you can use social media to personally apologise and put things right.

Don't dismiss paying

Yes, thereis a lot you can do with social media for free and when you are running a start-up on a tight budget that it is very important, but that does not mean you should automatically dismiss paid for services. Twitter and Facebook in particular have opened up the paid for promotion elements of their websites to businesses of all sizes and it's worth investing a few dollars to give it a go.

You can get incredibly targeted with social media adverts and promoted posts due to the amount of information the platforms know about people. If for instance you're running an event, set up a Facebook event page and spend a few dollars on targeting it at people who live in the area where it is taking place and are interested in the subject the event focuses on.

Use tools

There are tons of free and low cost tools that can help make your social media efforts more effective. There are too many to list them all, but here are some of the favourites:

- *Hootsuite:* Jam packed with features, this tool allows you to split your social media accounts into separate feeds and monitor particular topics or hashtags so you can cut through the noise. It also allows you to schedule tweets for future posting and access analytics.

- *Facebook Pages Manager app:* If you have a Facebook page for your business and you want to update it on the move then you need this app on your mobile device. You can manage up to 50 pages by checking user activity, sharing content and accessing insights. Facebook also now shows on your page how quickly you respond to queries from your fans so being able to update wherever you are is important.
- *Buffer:* All Buffer does is scheduling but it does it very well. Through a very simple interface you can schedule posts across multiple platforms. It also provides useful statistics for each post and re-send the most popular content with just one click.
- *Canva:* Data shows that social media posts containing images get more engagement and Canva allows you to create brilliant ones. You can build graphics, marketing messages, account header images, vouchers and more in the best size for each social media website. You can pay for images and icons to use but there are hundreds of free ones available.
- *Bit.ly:* Knowing how many people click on your social media links is useful and this tool allows you to create shortened links and track the traffic. You can also create custom links with words of your choice so if you've got a really long URL, you can shorten it and make it more memorable.

Beyond the marketing

Social media isn't just about marketing. It can also be used for recruitment, customer service and staff communication so embed it at the heart of everything you do. Don't just treat it as a tool to promote your stuff, either directly or indirectly.

Don't do it all

There are lots of social platforms and they all have their benefits but if your customers aren't hanging out on them what's the point of you being there?

Spend time working out which platforms are crucial for you to be present on and do those well. Particularly in the early days of a business when your time is a massively valuably asset, you don't want to waste your days posting on a site where you get limited engagement.

Look at your competitors and see with which platforms they're having success. The chances are it will work for you too. You could create a Twitter list that displays all their tweets so you can see what's working.

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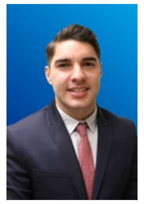
In the spotlight



Paul Montero
Audit Senior, KPMG Enterprise

Paul was born and raised in Gibraltar. After completing his GCSE's and A Levels he moved to the UK to pursue an undergraduate degree. Paul graduated from Oxford Brookes University in 2012 with an Honours degree in Accounting and Finance. From here he went on to join the Gibraltar office of another large accounting firm where he completed his training contract and became a full member of the ACCA in 2015. Paul has experience in a number of different industries which made a move to KPMG Enterprise appealing. His previous client portfolio includes work in financial services, retail, manufacturing and other service providers. After completing his training contract in Gibraltar, he joined KPMG Enterprise Bermuda as an Audit Senior. Here, he aims to add value and build on his previous knowledge. In his spare time Paul enjoys keeping active through sports, travelling and socialising.

Jonnie Burnett
Audit Senior, KPMG Enterprise

Jonnie was born in North London, raised in West Sussex and graduated from the University of Sussex in July 2011 with first class honors in Mathematics. He joined a medium sized accountancy firm in Central London, completing the ACA qualification to become a chartered accountant in September 2015. Jonnie has worked on a range of different industries including retail, manufacturing, property, professional services and software. He also specialised in charity audits. In his spare time, Jonnie enjoys keeping active - playing football and rugby, socialising with friends and playing the drums.

Nick Thomson
Staff Accountant, KPMG Enterprise

Nick Thomson was born and raised in Bermuda. He graduated in December 2015 from Florida State University with a double major in Finance and Hospitality Management. Nick has a deep passion for Bermudian business and is excited for all of the wonderful learning opportunities KPMG has to offer. In January 2016, Nick joined KPMG in the Enterprise department as a Staff Accountant. Nick hopes to excel in his career as well as continue to learn as much as possible about Bermudian business through his position. Nick will be taking the CPA examinations this year with hopes of being a qualified CPA by 2017. In his free time Nick enjoys a social lifestyle including spearfishing, personal training and golf with friends.

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