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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Dear Sir/ Madam/ Ms

**Submission to the Senate Inquiry into Family Business**

**Introduction**

1. Thank you for this opportunity to make a submission to the Senate Inquiry into Family Business. This submission specifically addresses the 3 points of the committee's terms of reference namely:

- Access to and the cost of finance and insurance for family business;
- Family business responses to the challenges of the GFC and post GFC resilience; and
- The availability and reliability of information and statistics about family business in Australia.

2. This submission recaps an earlier submission by Dr Chris Graves from the University of Adelaide and myself to the Senate Inquiry into Access of Small Business to Finance in April 2010, which was funded by CPA Australia, by focussing on the use of Private Equity (PE) amongst Small-to-Medium-sized Family Enterprises (SMFEs) in general, and specifically, whether PE can provide a practical solution to the upcoming succession crisis amongst SMFEs (Seet & Graves, 2010a, 2010b). It also updates some of the data presented in the earlier study and discusses follow-up research in this area since then conducted by the Australian Private Equity & Venture Capital Association (AVCAL) and PwC.

**Access to finance for family business - Access to Private Equity for SMFEs**

3. As a number of submissions to this inquiry have already pointed out, although the majority of family firms intend to pass the business onto the next generation, it is predicted that a large number will be unable to do so due to a lack of available and / or suitable successors. A consequence of this is that many family owners will have little option but to sell or close down the business. The scale of this problem suggests that not all family business owners can look forward to traditional exit options such as trade sales, and therefore alternative succession strategies, such as the involvement of PE, need to be considered.

4. The rapid growth of the PE sector in the last decade has resulted in new exit options through ownership restructuring deals with PE firms such as management buy-outs (MBOs). Because PE has increasingly been used in the ownership transition of family firms in developed countries, especially in Europe and North America, there is growing interest in whether PE

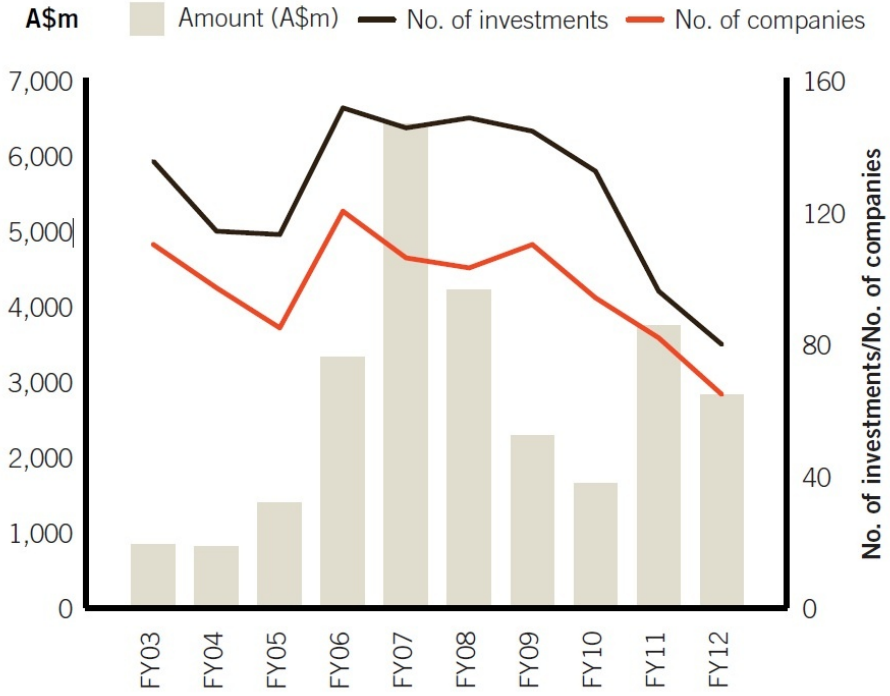


inspiring achievement

investors can provide a practical solution to the upcoming succession crisis amongst SMFEs in Australia.

5. The 2010 Senate submission noted that while there was sustained interest among PE investors to get involved in the SMFE sector, significant barriers exist between family business owners and PE providers which created finance, knowledge and empathy gaps between the two parties i.e. PE investment in SMFEs may be a theoretical possibility but not necessarily a practical reality in the Australian context (Seet & Graves, 2010b). This finding is still current today with recent research from AVCAL showing that although fundraising in the PE sector has grown by 54% in FY2012 as compared to FY2011 with particular resilience in the small- and mid-market segments, PE investments fell by 25% and only 28 PE managers completed new deals in FY2012 (see Figure 1), the lowest number of participants in a decade (AVCAL, 2012).

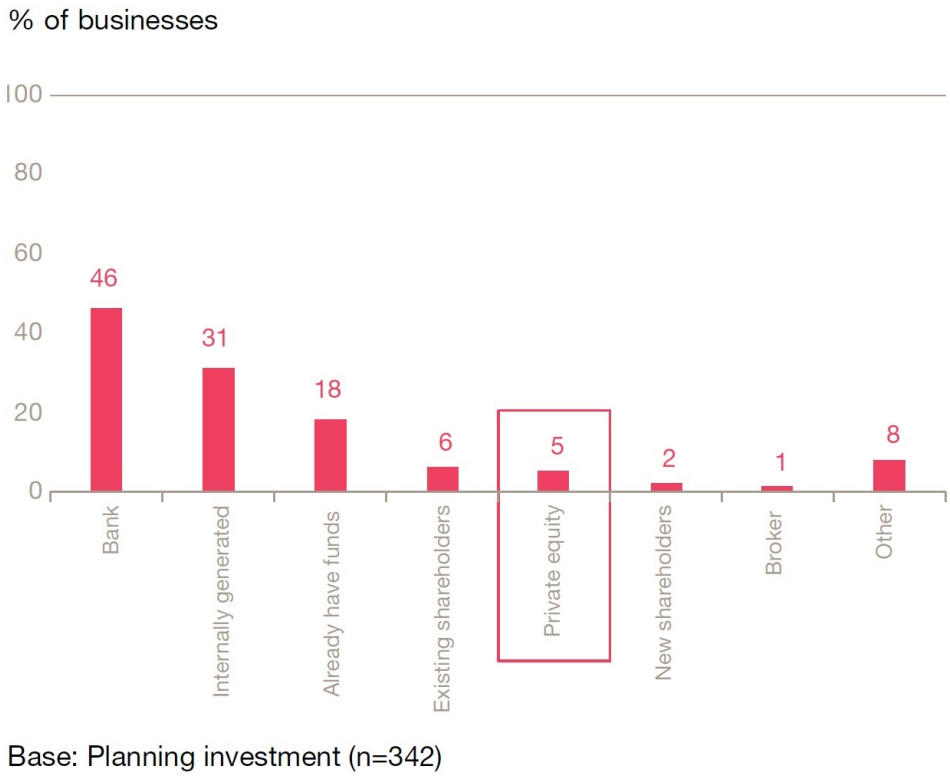
**Figure 1 – Australian PE funds raised by fiscal year (in AUD millions)**




(Source: AVCAL (2012))

6. In terms of interest among family business owners for using PE, PricewaterhouseCoopers (PwC), in collaboration with AVCAL, has recently conducted similar research and found "*that private equity (PE) may have something of an image problem. With a significant proportion of companies surveyed either planning investments or ownership succession (or both), there appear to be widespread misconceptions about what private equity is and the role it can play for owners considering investments and/or succession.*" (PwC, 2012b, p. 3). In this research, only 5% of respondents were considering private equity as a source of investment (see Figure 2). This is very similar to the 4% of family firms considering private equity as a source of investment which PwC found in a much more detailed study of a small group of 50 selected firms (PwC, 2012a).

**Figure 2 – % of Businesses Considering Different Types of Funding**




(Source: PwC (2012b))

7. PwC's survey focussed on firms with revenues of approximately A$10 million to A$100 million per year. Of these, only 10% of respondents had any experience with PE with 22% admitting that they did not know enough about private equity as an option (PwC, 2012b). This mirrors findings from our earlier research which focussed on even smaller firms namely SMFEs and we found that for these firms, many would look for advice on engaging with PE through their business advisers and especially through their accountants, their preferred advisers. (Seet & Graves, 2010b).

**Family Business responses to GFC - Have attitudes towards Private Equity changed after the Global Financial Crisis**

8. Before the collapse of Lehman Brothers in September 2008, Family Business Australia (FBA) commissioned a survey sponsored by KPMG and undertaken by Deakin University. It went out to two groups - the first group comprised members of FBA (536 FBA members); while the second group comprised 5,000 businesses from a random sample provided by Dun and Bradstreet. There were 1,080 completed questionnaires - a response rate of 34% from FBA members and 17% from the Dun and Bradstreet listing and 20% overall (see Glassop, Hagel, & Waddell (2008)). There was an exploratory question in the survey on family businesses consideration for using PE. And the study found that the majority were very amenable to this. Table 1 below present the results from the question about PE in the study:

**Table 1 – Would you consider using private equity for any of the following?**

| | **Yes** |
|---|---|
| Source of funds for growing the business | 45.7% |
| As a means to restructure ownership of the business | 43.3% |
| As a means to exit the business | 51.3% |

(Source: Glassop, Hagel, & Waddell (2008))

9. We were able to follow up the research in mid-2009, with a more comprehensive survey with a specific intent to analyze whether the GFC had any effect on these positive perceptions (Seet & Graves, 2010b). We followed procedures similar to the FBA commissioned survey but asked more specific questions. We were also able to map it out on a 5-point Likert scale from very unlikely (1) to neutral (3) to very likely (5). The results are shown in table 2 as follows:

**Table 2: SMFEs Degree of Preference for use of PE**

| Use of Private Equity Investment | | Average (n=125) |
|---|---|---|
| a. | As a source of funds for growing your business | 2.06 |
| b. | As a means to restructure the ownership of your business | 2.00 |
| c. | As a means to exit your business | 2.39 |

10. It is interesting to note that while the sample was of similar profile to the second group of the 2008 FBA survey, our research found that the SMFEs were unlikely to consider using PE. It appears therefore that the impact of the GFC was quite pronounced. However, this does not seem to be the case in a follow-on question later in the survey where more than three-quarters of the respondents said that the GFC had no bearing on them not considering the use of PE, with only about 10% still actively pursuing the option despite the difficult circumstances and about 13% considering it only after the economic conditions change. The results are in table 3:

**Table 3: In the light of the current Global Financial Crisis, which of the following statements do you agree with the most? (Please tick one only)**

| Statements | | % |
|---|---|---|
| a. | We will NOT consider engaging with and/ or using PE investment and do not think the current Global Financial Crisis has an impact on our decisions | 76.8 |
| b. | We were considering engaging with and/ or using PE investment before the onset of the Global Financial Crisis, but have decided not to proceed for the moment | 3.4 |
| c. | We are still actively considering engaging with and/ or using PE investment now despite the current Global Financial Crisis | 10.3 |
| d. | We will only consider engaging with and/ or using PE investment after the current Global Financial Crisis is over | 12.8 |

While the information supplied may suffer from retrospective bias, the research findings are consistent with other more recent research. For example, in its Private Business Barometer, PwC has found that interest in PE has not changed much and has consistently varied between 1% to 5% (PwC, 2012b).

**The availability and reliability of information and statistics about family business in Australia**

11. The last time the family business question was used in the BLS by the ABS was in the 2004-2005 edition of the BLS. As such, the more recent research on family businesses, as shown above, has had to rely on self-collected data, which due to resource and data limitations, makes it harder to reliably answer some of the questions, that the Senate inquiry would like to consider in a more reliable manner, especially those requiring longitudinal data (e.g. how family businesses were before the GFC, how have they responded to the GFC, and how have they changed since the GFC).

**Summary of Findings**

12. In summary, the recent research conducted by AVCAL and PwC reinforces our earlier research findings that the engagement of SMFE owners with PE investors is limited by the

existence of finance, knowledge and empathy gaps between SMFE owners and the PE sector (Seet & Graves, 2010b). Specifically:

a. Finance gap. Compared with their non-family counterparts, SMFEs face a finance gap when it comes to attracting capital from PE providers due to both supply and demand factors. On the supply side, SMFEs are less likely to receive capital from PE firms because of prohibitive transaction costs, and potential risks stemming from information asymmetries (lack of transparency) and a perceived lack of professional management and practices. On the demand side, family business owners may face a self-imposed finance gap because of their attitudes (antipathy) towards and knowledge of PE.

b. Knowledge gap. SMFE owners' degree of knowledge and understanding of PE have a significant influence on their attitude towards using PE (regardless of whether it is for growth, restructuring ownership or exit). Our research suggests that owners have limited knowledge of what PE is and how it can assist them in realising their objectives. At the same time, PE providers also have a lack of understanding of family business dynamics and what is important to family owners. Owners are most likely to approach their accountant when seeking advice on financing and PE. Also, CPA and CA qualified external accountants from larger accounting firms are perceived as being more able to advise SMFE owners on PE.

c. Empathy gap. SMFE owners' attitudes towards using PE are largely influenced by their intended succession/exit strategy, their understanding of PE and whether they emphasise financial or lifestyle objectives. Interestingly, our research has found that there is no statistically significant difference in attitude to PE between family and non-family firms (regardless of how a family business is defined). So being a family business does not, in itself, influence attitudes to PE and this may be generally reflected over all Small-to-Medium-sized Enterprises, whether family-controlled or not. Rather, it is the attributes of the owners (intended succession/exit strategy, knowledge of PE, objectives) which determine attitudes towards PE.

13. Our research and others that have been conducted, especially since the mid-2000s have relied on self-collected data and these are largely cross-sectional in nature. This limits the understanding of whether family firms really change their behaviour over time for example, because of major economic shocks like the GFC. To improve the reliability of this research would entail conducting research longitudinally and differentiating family from non-family firms.

**Recommendations**

14. Based on these findings, the following 4 recommendations are proposed.

1) Because owners' knowledge and understanding had a significant influence over attitudes towards using PE, the government should facilitate the use of PE amongst SMFEs by supporting confidence building activities and education of SMFE owners on PE and how it can assist them in ways such as growth and succession / exit. Such activities and education could be through seminars conducted by industry and government associations, as well as family business networks such as Family Business Australia.

2) As accountants are the preferred source of advice to owners on financing and PE, it is important that the government support any effort of accounting professional bodies equip their members with the requisite knowledge on PE. Given that many SMFEs do not use accountants from the Big 4 or Tier 1 firms, these efforts should also target public accountants operating in small practices or as sole practitioners.

3) To lower the perceived risks, information asymmetries and transaction costs associated with investing in family firms, the government should support activities whereby accountants (their preferred advisers) can assist SMFE owners in professionalising the management of the firm. Specifically, SMFEs are in need of assistance in developing strategic business plans and succession plans, the establishment of independent / advisory boards, the utilisation of outside managerial expertise and the development of performance measurement systems. In addition to accessing PE, professionalization will benefit SMFEs in other ways.

4) To help understand whether major economic events like the GFC have impacted on these issues for family firms differently from other firms would entail collecting longitudinal data. While it is recognised that there are definitional issues for what makes a family firm and that the recent editions of the BLS have asked more detailed financing questions, it would be ideal if the ABS could help in this by reinstating one or more of the family business questions in the BLS.

15. Should you have any questions regarding this submission please contact me.

Yours sincerely,

<Submitted via e-mail>
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