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28 November 2012

Committee Secretary
Parliamentary Joint Committee on Corporation and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600 Australia

Dear Chairman and Committee Members,

I would like to take the opportunity to offer comments in support of your inquiry into Family Businesses in Australia. I am an accredited Family Business Adviser and the director of a family business that acts as an independent adviser to Family Owned Businesses; we seek to provide professional guidance to firms tackling challenging problems ranging from capitalisation to transition planning.

In response to your stated terms of reference, I offer the following comments:

1. **Access to capital for family businesses:**

The ability to finance growth incorporating investment in R&D, new market development, (international and domestic) capital projects and intra and or intergenerational liquidity events remains one of the critical issues facing family owned businesses today. According to the MGI Australian Family and Private Business Survey of 2011, over 90% of family businesses bank with one of Australia's Big Four, who are traditionally reluctant to supply credit. Faced with the impossibility of accessing credit through traditional channels, most family businesses fund growth with family savings, through current income, or are forced to constrain their growth.

Whilst many recommendations centre on forcing the banks to change their real or perceived assessment of risk regarding family owned business, the owners should instead seek to understand if their expectation of banks is realistic. That is, are the banks necessarily capable of managing what is likely to be equity risk as opposed to credit risk secured by tangible assets?

I believe that the answer lies in shifting our focus to a Private Equity model. While the matter requires a much more detailed explanation, based on our experience with multigenerational family businesses, it is clear that shifting to a Private Equity framework allows the alignment of Family owned businesses seeking investment with investors who understand their strengths, ownership structure, and need for "Patient Capital." Patient Capital investors can be characterised by their long-term outlook, tolerance for risk, and interest in developing a flexible

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partnership. Family owned businesses that are stable, well documented, have a track record of success, and do not have a propensity to over-borrow will succeed under this regime. It follows that an investment match is more likely to occur if the investor is another business-owning family.

Furthermore, recent history suggests that with an expected return from this class of 30% and an actual return over the last years of 7%, this market is falling short of investor and investment manager expectations. Providing capital to well-managed Family owned businesses that have the capacity to be leaders in a global economy is an emerging private equity market that offers an opportunity to increase investor returns. It does require significant expertise with the unique features of business families and requires a deeper understanding by all stakeholders. To facilitate the provision of equity to this under-served market, FINH is actively developing an international alliance of family groups across the globe to participate in our Family Capital Partners initiative.

Research and international best practices suggest that successful multigenerational family businesses deal with transition of leadership and ownership within a governance system that merges the interests of the family and the business so that they are a fully integrated system as opposed to two separate systems. Doing so helps ensure the best possible succession for business and family. Government has an interest in ensuring the longevity of family businesses because available research suggests that they are more profitable and stable than non-family businesses. The current Capital Gains Tax (CGT) regime makes it difficult and expensive for companies to pass ownership to the next generation during the current generations lifetime, as the most tax-beneficial transfer can only happen after the current owners death. Since early transition planning is key, families have a difficult choice to make: make the best decision for the business and family, or avoid the taxes.

**Recommendation:** That Government specifically look at the present incentivisation of the private equity markets and identify performance-enhancing policy measures that incorporate a greater level of knowledge of the capital needs of successful multigenerational business owning families. Further that Government offer incentives to increase access to capital by family businesses acknowledging that current private equity incentives provided are not directly targeting this sector and/or are potentially relying on the wrong model of distribution. Additionally, that Government make amendments to the CGT to ensure that existing family shareholders are not subject to CGT where transitions are appropriately being planned and implemented during the lifetime of the current owners.

**2. Access to family business-specific education:**

Because of their unique structures, family businesses benefit strongly from highly specific education designed to enhance their longevity and ease the transition between generations. Transition planning remains a critical challenge to many family businesses. A 2006 survey by Deakin University showed that although 61% of family-owned businesses would face transition within the next decade, 78% had no transition plan in place. Research shows that only 35% offamily businesses are able to successfully transition to the second generation; of those, only further 20% make it to the third generation. Clearly, more transition education is necessary.

We work with our clients to develop formal structures and transition plans to protect their businesses and families. Some of the common issues we see are governance issues related to managing the roles of family and non-family employees while maintaining family harmony. Education and training related to family business governance is critical to increasing productivity and mitigating the risk of economic loss and damage to the family caused by poor communication.

**Recommendation:** Resources specific to family businesses are available through organisations and industry partners. We strongly encourage Government to support these initiatives through publicity, funding, and the inclusion of such courses in existing Business Enterprise Centres and Regional Development Boards.

In closing, we want to extend our thanks for Family Business Australia and Senator Sue Boyce for being instrumental in raising this issue before Parliament.

Sincerely,

David Harland
Managing Director, FINH