



FAMILY BUSINESS
**WEALTH & KNOWLEDGE
TRANSFER REPORT**

Report prepared by Australian Centre for Family Business at Bond University for BDO Australia

BDO

About the research

The BDO Family Business Wealth & Knowledge Transfer Report was prepared by the Australian Centre for Family Business at Bond University for BDO in Australia

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Foreword

The BDO Family Business team is pleased to present this report which considers an issue of growing importance to all family businesses - wealth and knowledge transfer.

Never has this issue been more important as the baby boomer generation fast approaches retirement in ever increasing numbers, and with many family businesses unprepared for what lies ahead for both their family and their business. Just like the seasons in nature change, the issue of inter-generational transition cannot be ignored. We cannot stop Summer turning to Autumn, nor Autumn to Winter, but we can be informed and prepared in the process of succession and planning for retirement from the family business. This report provides a comprehensive view of wealth and knowledge transfer to assist family businesses with their preparations for the future.

The report includes detailed survey results from family owned businesses in Australia, revealing what was already suspected, and what BDO has witnessed over decades of advising family businesses, that family owned businesses are under prepared for their wealth and knowledge transfer. Using the 4L framework: learn business, learn the family business, learn to lead the family business, then learn to let go, the report highlights that learning to 'let go' is the major contributor to the level of preparedness for wealth and knowledge transfer. With learning to let go not so much an event as a process of transition, this can take some time. We hope that the detail in this report will assist family businesses to think about the process for the wealth and knowledge transfer for their business as they work towards a smooth transition to the next generation.

We hope you enjoy reading the BDO Family Business Wealth & Knowledge Transfer Report.



SUSAN RIX
National leader, Family Business

"Within the next five years, as the baby boomer generation pulls back from the businesses they have built and move to retirement, arguably, this will be the largest transfer of wealth in history."

Executive summary

“Knowledge transfer is the key to successful wealth transfer”

This survey examines the wealth transfer intentions of 320 businesses, the majority of which classified themselves as family businesses. More than 38% of the surveyed respondents indicated their intention to transfer wealth within the next five years. To successfully transfer the business to their successor, incumbents need to prepare the successors and themselves to ‘let the firm go’.

Preparing to let go is more than putting a succession plan in place and identifying a successor, which 39% of those surveyed have already done. For the transfer to be successful, and to enhance the probability of success, successors need to be developed and nurtured over time. A potential successor must *‘learn business’*, *‘learn the family business’* and *‘learn to lead the family business’*. A key element is the transfer of knowledge, in particular the tacit knowledge of the incumbent. Over 75% of family businesses indicated they intend to transfer this knowledge over the next four to five years, ultimately preparing the successor for successful wealth transfer.

Main findings of the survey:

Wealth transfer

- 93% intend to transfer business wealth within the family
- 7% intend to transfer business wealth outside the family
- *Individual, Business and Beneficiary level considerations shape planned transfers.*

Family business valuation – how much do we have to transfer?

- In preparing to let go and transfer the family business wealth, incumbents need to know the ‘size of the pie’ – how much the business is worth
- 21% of family businesses have never been formally valued
- Financial performance, risk and value of family firms is driven by unique family factors including level of professionalisation, generational stage and family involvement requiring a specialised valuer with experience and skills.

Transfer preparedness

- 39% have a complete succession plan that nominates a CEO successor
- A succession plan is noticeably less sophisticated for family successors
- Over 70% have no professionalised management or governance.

Knowledge transfer

- Transfer of family business knowledge is critical to the success of wealth transfer
- Firms with formal succession plans emphasise:
 - The successor’s formal education and work outside the business – *‘learning business’*
 - The successor’s networking skills – *‘learning the family business’*
 - Codifying knowledge, training in operational and financial management, and thinking strategically in the business – *‘learning to lead the family business’*
- Successful multi-generational firms are more adept at managing the transition steps – *‘learning to let go’*.

Implications for wealth transfer

Family business as a sector represents two thirds of businesses in Australia, employing a significant proportion of the workforce and contributing significantly to the health and wealth of the economy. In the coming years, it is anticipated that a large number of baby boomer generation business decision makers will be transferring their business wealth and knowledge as they move into retirement. It is expected that the collective effect of the transference of wealth will be far reaching throughout all segments of the economy and that inter-generational change will pose significant challenges for family businesses, yet little to no research has been conducted on the possible impact of this change.

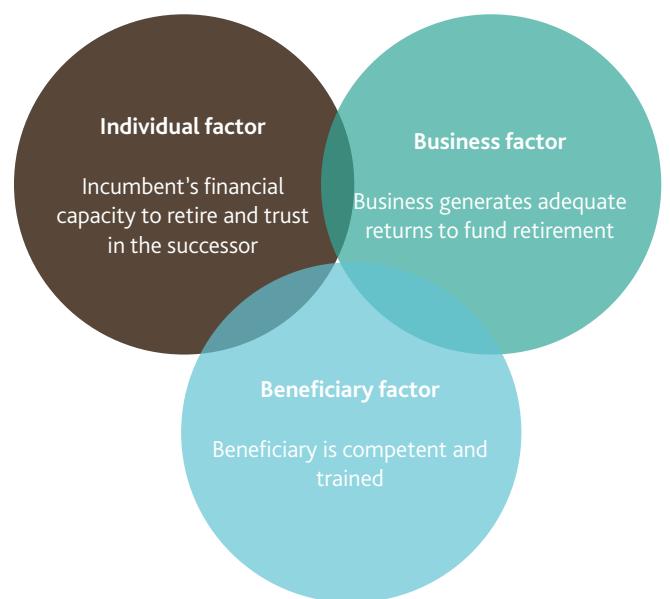
After years of creating the building blocks of understanding family business within BDO and the greater community, through previous research and thought leadership, we present this research to provide the family business community with information that will help them protect the interests of both the family and the business as they contribute to this unprecedented degree of wealth transference. We have sought to better understand the dynamics of wealth and knowledge transfer in these challenging times, and identify key trends and issues that will enhance successful transitions within private businesses.

With nearly 40% of family firms looking to transfer wealth in the next five years, it is critical for the economy that family firms are prepared to meet the challenges of wealth transfer and maximise the probability of successful transfer to the next generation. Wealth transfer for families in business, while important to the incumbent and successor family members, is a transition that is only likely to be successful if the incumbent family member:

- Wants to transfer the wealth to a family member (93% do)
- Is ready to transfer wealth (68% have four or more years to effect the transfer)
- Has imbedded a culture and desire for multi-generational stewardship within the firm.

"Many family firms are currently under-prepared for wealth transfer and lack sophistication if the plan is to nominate a family successor. These findings are consistent with our practical experience and highlights the need to plan wealth transfer for success."

The wealth transfer is impacted by factors perceived as important by the incumbent:



Many family firms are currently under-prepared for wealth transfer. Only 39% have a complete succession plan that nominates a CEO successor, and the sophistication of the succession plans are noticeably reduced for family successors. Over 70% of family businesses have not professionalised their management or governance structures, and are yet to engage in the difficult process of 'letting go' of management and board control.

In preparing to 'let go' and transfer the family business, incumbents need to know the size of the pie and how much the business is worth. Astonishingly, 21% of the family businesses surveyed have never undergone a formal valuation. Such valuations require professional skills, given the intertwined nature of the business, the family and the unique family factors that drive value.

A critical element in being able to 'let go' is investing in the process of knowledge transfer for the nominated successor. Firms with formal succession plans require successors to: (1) '*learn business*' through formal education and working outside the business; (2) '*learn the family business*' in particular the family network and network management skills; (3) '*learn to lead the family business*' by codifying knowledge and learning the tacit knowledge, training in operational and financial management, and thinking strategically in the business. The most successful multi-generational firms are those who are more adept at managing these factors.



Family business wealth transfer

This report finds that 38% of family owned firms will transfer their wealth within the next five years, as the baby boomer generation pulls back from the businesses they have built and move to retirement. Arguably, this will be the largest transfer of wealth in history. The question is "*are the businesses and family members ready, and what are the key success factors for a successful transfer?*"

Successful transition of the family business and family wealth is naturally important to the parties involved, and it is even more critical to the health and welfare of the economy. Family businesses comprise more than two thirds of the businesses in Australia and employ a significant proportion of the workforce. The family business sectors range in size from small to medium enterprises, through to large private and public companies. Economically, family businesses as a whole contribute between 45% and 70% to the country's GDP and touch every sector (Connolly & Jay, 1996; Moores & Mula, 2000).

Given the potentially far reaching economic impact of the looming family business wealth transfer, it is important to ask '*are we ready?*' and if not '*what should we do to get ready?*'. There is, however, little research on the preparedness and success factors that underpin this fundamental shift in our economic base. US evidence by Williams and Preisser (2003) suggests that 70% of wealth transitions fail. Typically, the failure in transition is attributed to a breakdown in communication and trust in the family unit, and a lack of preparation of the next generation. Successful transition requires soft skills such as communication, knowledge transfer and learning, in addition to building industry, network, and entrepreneurial skills.

The 4L framework¹ helps to identify the issues pertinent to family firms, given the additional layer of complexity created by intertwining the family and the firm. '*Learning to let go*' as well as the value of '*stewardship*' give a unique insight into the issues of transfer of wealth and knowledge. The wealth transfer process, like any other change process, can be a difficult one for all parties involved. However, it can be made much less painful if the family has the 4L building blocks in place and adopts stewardship thinking into its culture.

'*Learning to let go*' is not so much an event as a process of transition. In the first stage, the incumbent family business leader has to consider whether the business should be sold and to whom. Where the decision is made to retain the business in the family, the question arises as to what qualities the new leader will need. Developing the new leader involves multi-layers of knowledge transfer. Ultimately, the '*learning to let go*' stage culminates in planning the wealth transfer.

This report surveys the timing of, the motivations for, and the method to transfer family business wealth and knowledge. The survey was conducted by the Australian Centre for Family Business, Bond University, and examines the wealth transfer intentions of 320 respondent businesses. The majority of the respondents classified themselves as family businesses and more than 38% of the surveyed respondents indicated their intention to transfer wealth within the next five years, highlighting the importance of this research.

"Economically, family businesses as a whole contribute between 45% and 70% to the country's GDP and touch every sector."

"US evidence suggests that 70% of wealth transitions fail."

"The question is "are Australian businesses and family members ready, and what are the key success factors for a successful transfer?"

¹The 4L framework comprises: learning business, learning the family business, learning how to lead the family business, and finally, learning to let go of the business.





Are we a family business?

More than two thirds of respondents considered themselves to be family businesses.

This distinction is important, as families are intertwined with their family businesses, and wealth transfer is a key issue for these firms. Handler (1994) describes the issue of succession as the most important issue that all family firms face and Sharma et al. (2003) find that succession is the number one concern of family firms.

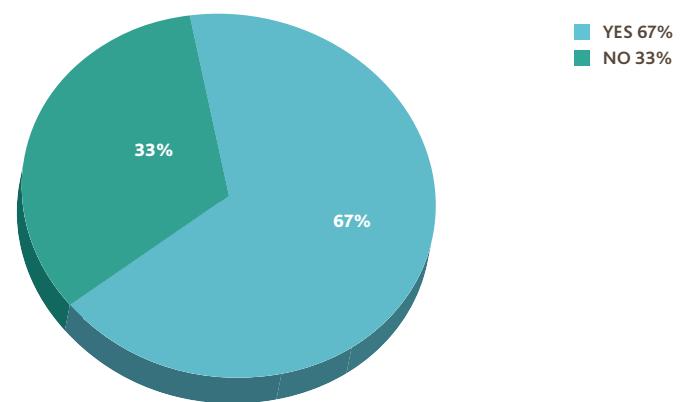


FIGURE 1: SHARE OF FAMILY BUSINESSES, IN PERCENTAGE

Ward (1997) goes so far as to define all family firms specifically as those that will be "passed on for the family's next generation to manage and control". The firms that identified themselves as a family business were asked to state what factors they considered made them a family business.

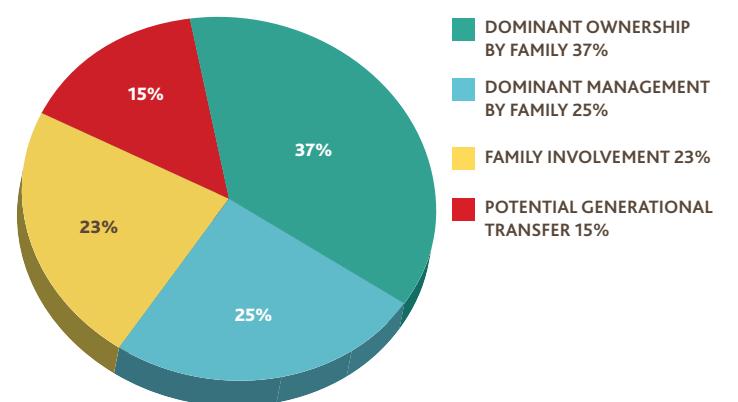


FIGURE 2: WHAT MAKES THEM A FAMILY BUSINESS, IN PERCENTAGE

The most prevalent reasons respondents self-identified as a family business are: (1) dominant family ownership (37%), (2) dominant family management (25%), (3) general family involvement (23%), and (4) potential generational transfer (15%). These elements are all part of the typical definition of a family business.





Timing of wealth transfer

The amount of wealth to be transferred by the Baby Boomer generation in coming years is unprecedented (Lusardi & Mitchell, 2007). In the context of family firms, this transition will require careful financial planning, as well as successor development and nurturing. Emerging evidence suggests that the Baby Boomers will live longer than their predecessors. Hence, incumbents and next generation family members need to be cognisant of not only financial needs and expectations, but also the likelihood that career trajectories will be different from what was previously considered the norm.

Our survey indicates that 38% of businesses surveyed intend to transfer wealth within the next five years. In this group, 16% plan to transfer wealth within the next one to three years, 22% plan to transfer wealth in the next four to five years, and 46% intend to transfer wealth in more than five years.

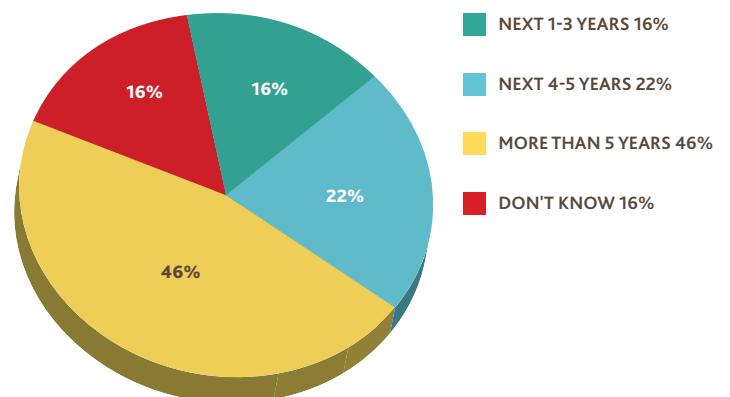
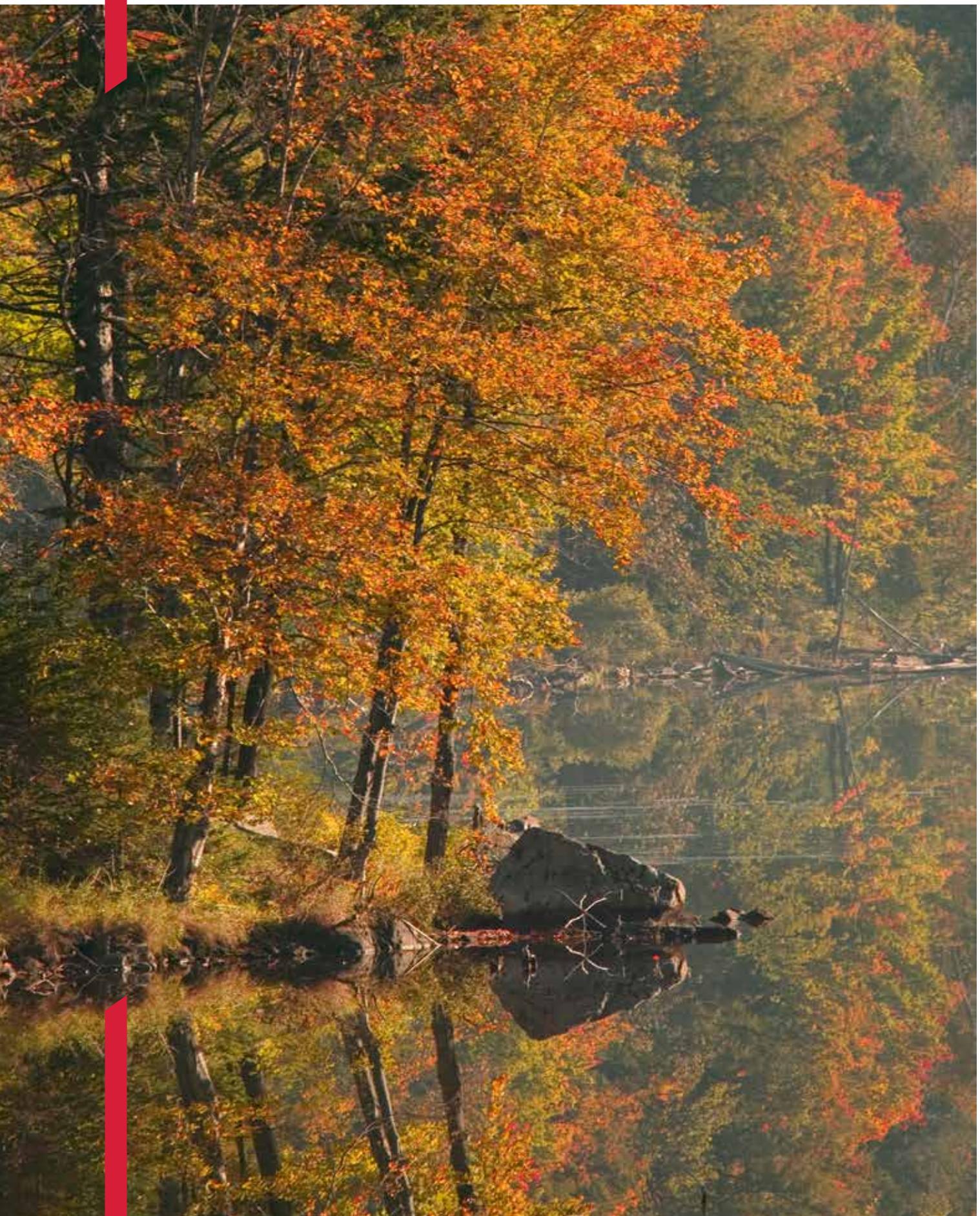


FIGURE 3: TIME HORIZON OF WEALTH TRANSFER, IN PERCENTAGE

It would be all too easy to think that there is ample time for preparations given more than 75% of firms have four or more years to plan for the wealth transfer. However some preparation, especially preparing for the incumbents tacit knowledge transfer, can take several years. 'Letting go' is a long term transition process that starts with educating the successor about business.

"75% of firms have four or more years to plan for the wealth transfer. However, preparing for the incumbents tacit knowledge transfer, can take several years."

"A long term transition process starts with educating the successor."



Wealth diversification

For family businesses, wealth transfer is an especially important issue since the majority of the family's wealth is invested in the family business (Sirmon & Hitt, 2003). When asked about the degree of wealth diversification, family firm respondents indicated that either all, or a great majority of their wealth is invested in the firm. Families in business are relatively undiversified. Specifically, if we consider those firms that only have 'some' capital invested external to the firm as undiversified, then on average, family firms have more than two thirds of their wealth inside the firm.

“...on average, family firms have more than two thirds of their wealth inside the firm.”

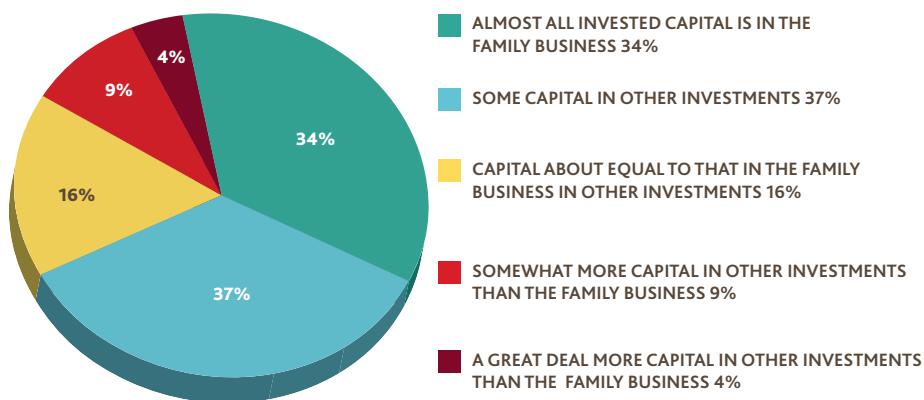


FIGURE 4: CAPITAL INVESTMENTS OF FAMILY BUSINESS SENIOR-DECISION MAKERS, IN PERCENTAGE

Potentially these undiversified family firms may have significantly different considerations when transferring this wealth to subsequent generations, where under-investment and suboptimal decisions are possible. Gomez-Mejia et al. (2010) note that family firms are loss averse when it comes to threats to their wealth (financial, social and emotional) invested in the firm. This can have negative consequences in particular: "if diversification implies a loss of... [wealth], family owners would prefer to avoid that strategic choice even if it confers some risk protection. This suggests that family firms are pulled in two opposite directions when making diversification decisions: opt for less diversification in order to preserve... [wealth] or choose greater diversification (as suggested by portfolio models...) in order to dilute or spread concentrated business risk but at the expense of family... [wealth]. We argue that the first tendency predominates." (Gomez-Mejia et al., 2010).

In a recent review of existing research, Eberhard and Craig (2013) revealed that the low wealth diversification of family business owners also hinders the firms' internationalisation efforts. This is counterproductive, since an international focus becomes increasingly important. By accessing larger markets, internationalised companies achieve economies of scale and scope, increase manufacturing efficiencies, recoup investments more efficiently, and gain access to foreign technological, marketing, and management know-how (Manolova et al., 2010; Zhou et al., 2007), all of which contribute to a sustained competitive advantage (Lages & Montgomery, 2004). On a national level, international firms generate social wealth and help national industries to boost productivity (Lages & Montgomery, 2004).

"42% of family businesses generate all their sales domestically."

The survey confirms the low international exposure of Australian family businesses. Specifically 42% of family businesses generate all their sales domestically. In comparison, most non-family firms have international sales, with only 29% of non-family firms operating exclusively within Australia. Of the firms that are internationalised, there are a significantly greater proportion of non-family firms (61%) versus family firms (46%) in the moderate internationalisation category (between 1% and 50% of their sales are international). In contrast, there is a greater proportion of family firms in the high internationalisation category (more than 50% of their sales are international).

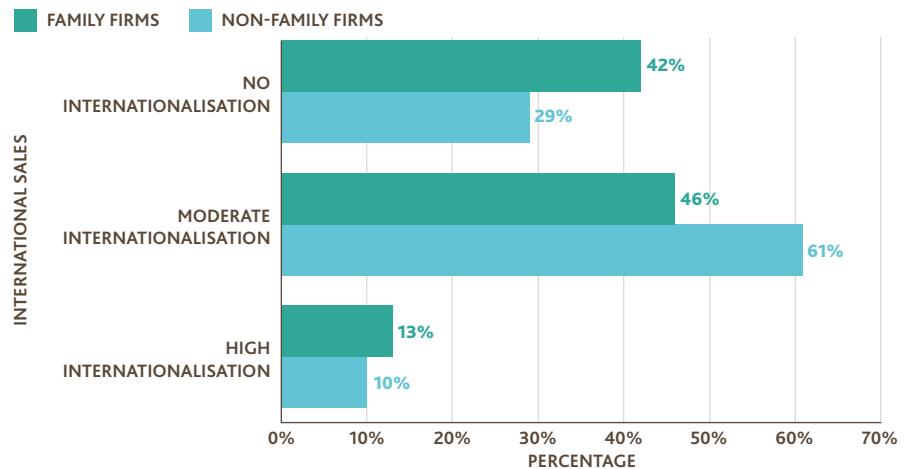
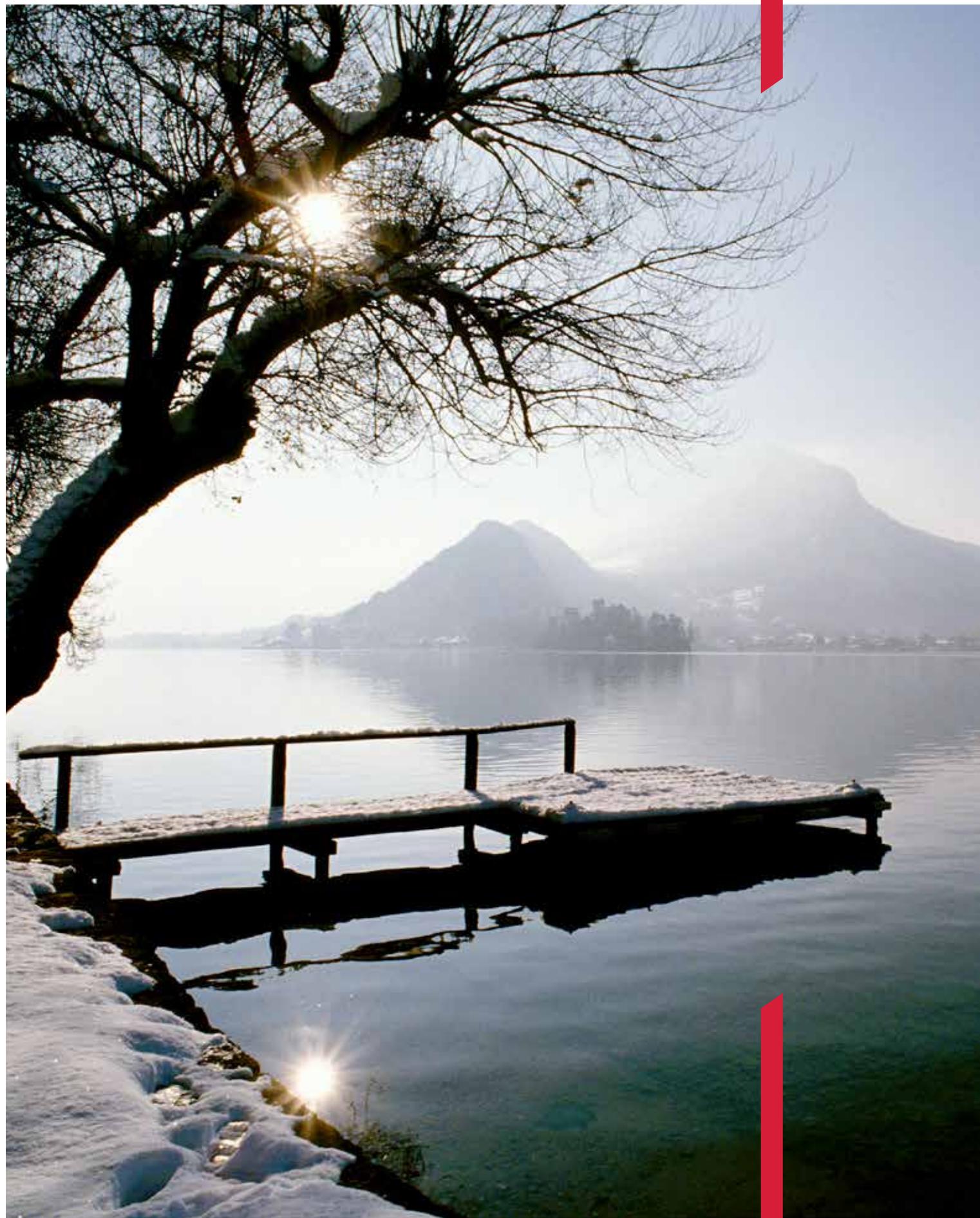


FIGURE 5: PROPORTION OF FIRMS BY DEGREE OF INTERNATIONAL SALES

The survey results support Eberhard and Craig's (2013) notion that high wealth concentration in family businesses makes the owners reluctant to lose control or to pursue expansive entrepreneurial growth strategies such as internationalisation (Storey, 1994).

"...high wealth concentration in family businesses makes the owners reluctant to lose control or to pursue expansive entrepreneurial growth strategies such as internationalisation."



Motives for wealth transfer

"93% of respondents intend to transfer wealth within the family."

To investigate respondents' intentions to transfer wealth in the future, we asked whether they plan to transfer wealth *within* the family (i.e. to the next generation or other family members), or whether they plan to transfer wealth *outside* the family (i.e. sell the business).

Transfer mode

The family business literature suggests that families in business ensure family control of the firm by making it difficult for non-family members to gain ownership and control stakes (Westhead & Howorth, 2006). This situation can potentially have negative effects as it provides the potential for problems due to 'honest incompetence', which can lead to barriers to firm survival and business development (Chrisman et al., 2004a).

We observe that 93% of respondents intend to transfer wealth within the family, whereas the balance of the respondents plan to transfer wealth outside the family.

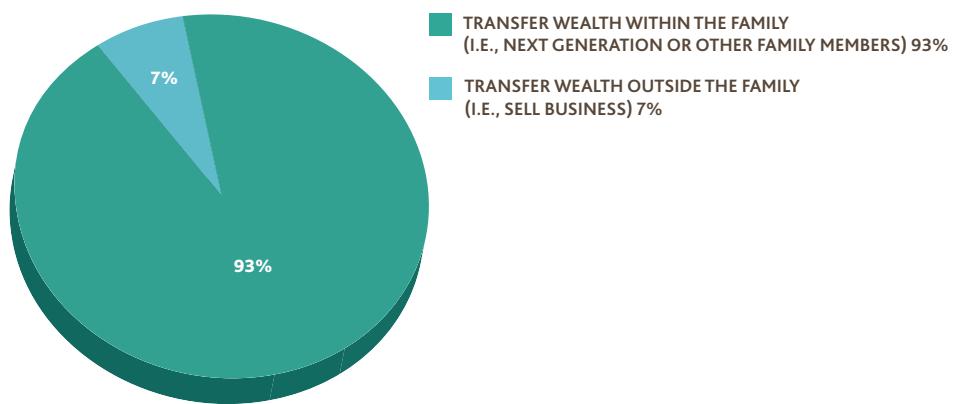


FIGURE 6: MODE OF WEALTH TRANSFER, IN PERCENTAGE

In addition to the wealth transfer mode, the various motives behind the wealth transfer can offer a better understanding of the reasons why firms transfer their wealth. The extant literature states that numerous wealth transfer motives may coexist with each other.

"For those who plan to transfer wealth outside the family, it was most important to establish an investment vehicle to grow future wealth."

"Those who plan to transfer wealth within the family consider it most important to provide security for the family's future."

When asked to rate the overall importance of various alternative motives, we analysed the responses for differences according to whether they intend to transfer wealth *within* or *outside* the family. For respondents who plan to transfer wealth outside the family, it was most important to establish an investment vehicle to grow future wealth. Respondents who plan to transfer wealth within the family consider it most important to provide security for the family's future. This reflects stewardship behaviour in that stewards are intrinsically motivated by higher-level needs to act for the collective good of the family business. Family stewards identify with the business by embracing its objectives, and they are committed to the firm's success even at personal sacrifice (Davis et al., 2000).

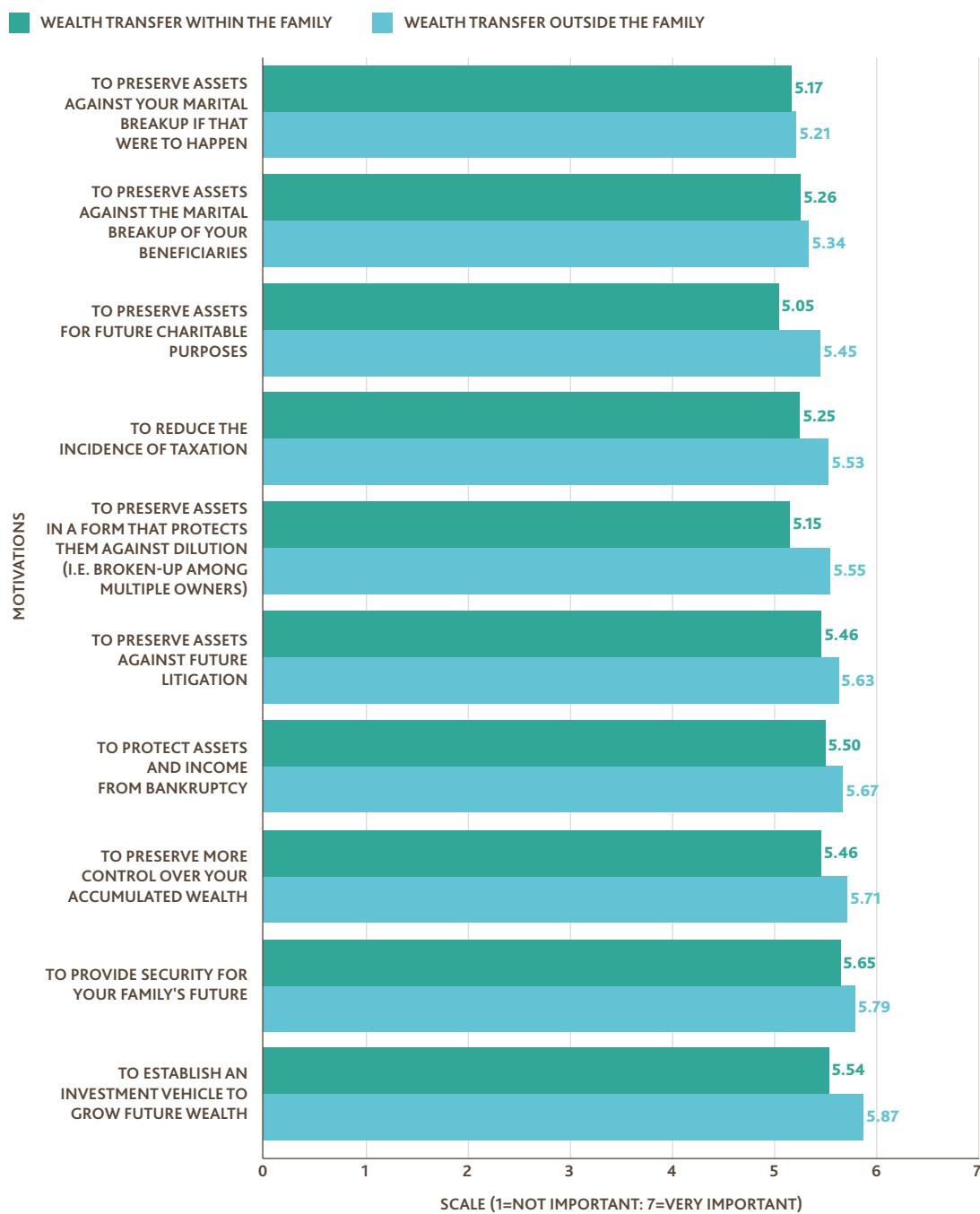


FIGURE 7: AVERAGE MOTIVES OF WEALTH TRANSFER (WEALTH TRANSFER WITHIN THE FAMILY VS. OUTSIDE THE FAMILY)

Individual financial security

The incumbents' individual financial security also impacts their motives and modes of wealth transfer. The survey measures financial security of the incumbent across five financial dimensions namely: income, asset, credit, stability, and savings. We developed an aggregate index based on these dimensions to represent the respondent's overall financial security.

We then split the sample into the two based on high and low financial security, and looked at the motives of two groups, incumbents with greater financial security and at the other end of the spectrum, those with lower financial security. We expect that levels of financial security will impact the purpose of the wealth transfer.

Looking at the motives of wealth transfer, we can see that respondents with greater financial security have the following top three motives of wealth transfer: investment vehicle for future growth (mean = 5.92), preserve assets from dilution (mean = 5.90), and provide security for the family's future (mean = 5.63).

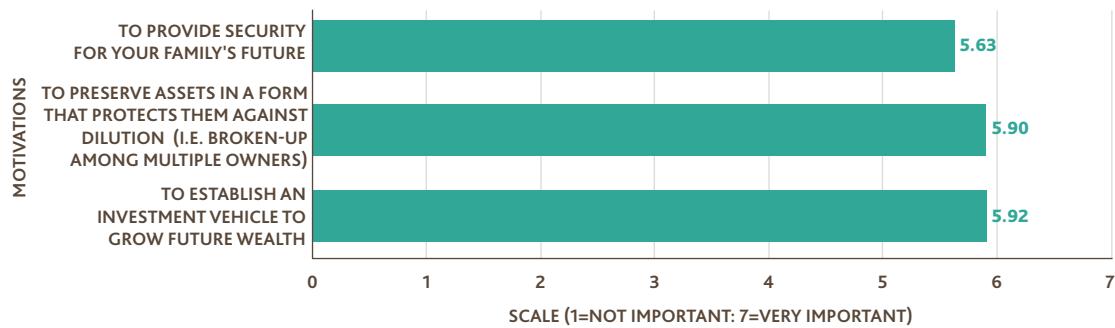


FIGURE 8: AVERAGE MOTIVE TO TRANSFER WEALTH - INCUMBENTS WITH GREATER FINANCIAL SECURITY

For incumbents with a low financial security, we find a different order for the motives of wealth transfer. For these respondents providing security for their family's future (mean = 5.48), providing an investment vehicle for future growth (mean = 5.46) and protecting assets from bankruptcy (mean = 5.41) were rated the most important drivers.

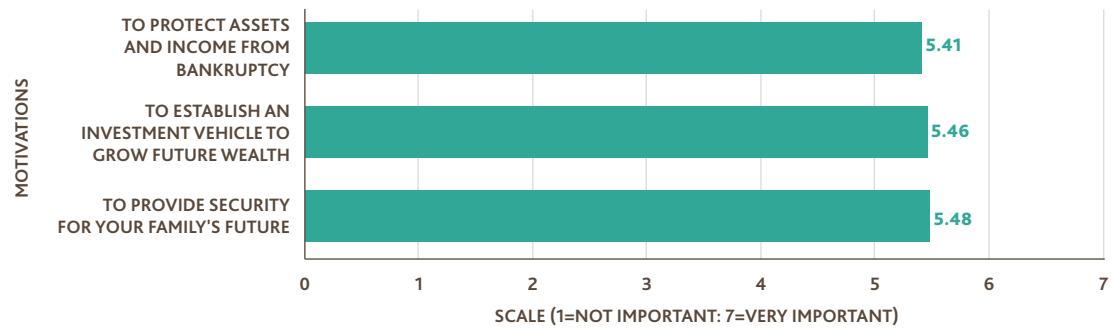


FIGURE 9: AVERAGE MOTIVE TO TRANSFER WEALTH - INCUMBENTS WITH LOWER FINANCIAL SECURITY

"The motivations for wealth transfer differ according to the incumbents personal financial security. It is easier to 'let go' or transfer the vehicle for wealth when financially independent of the business."

Looking at the modes of wealth transfer, incumbents with a greater financial security choose more often to transfer wealth within the family (92.31%) than respondents with a low financial security (90.24%).

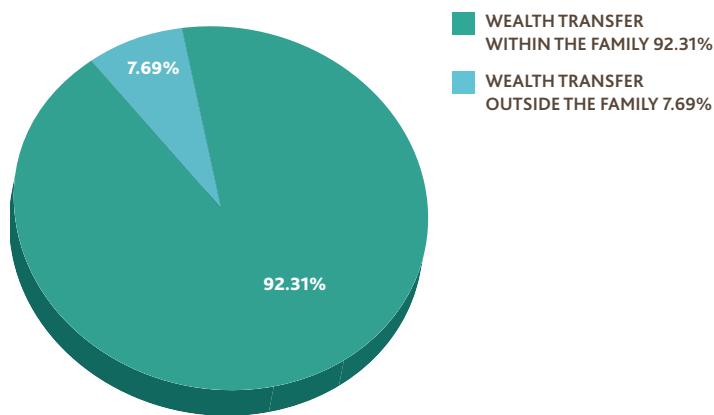


FIGURE 10: MODE OF WEALTH TRANSFER (INCUMBENTS WITH GREATER FINANCIAL SECURITY), IN PERCENTAGE

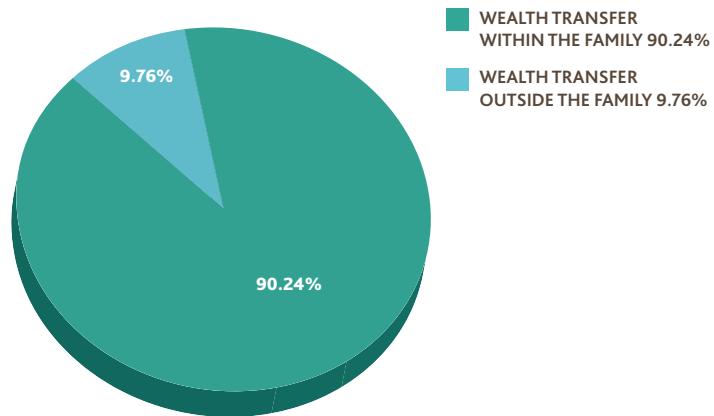


FIGURE 11: MODE OF WEALTH TRANSFER (INCUMBENTS WITH LOW FINANCIAL SECURITY), IN PERCENTAGE

However, these differences are marginal, and we can say that over 90% of all incumbents, irrespective of their financial security, intend to transfer the family wealth to a successor within the family.

In cases where the business will be sold and wealth is first transferred outside the business, we find most incumbents with high financial security (48%) opt to distribute the proceeds from the sale according to current ownership proportions.

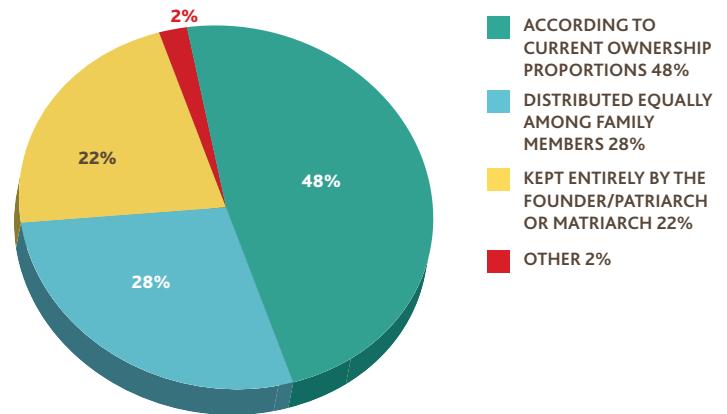


FIGURE 12: DISTRIBUTION OF WEALTH, IF BUSINESS SOLD (INCUMBENTS WITH GREATER FINANCIAL SECURITY), IN PERCENTAGE

When we compare this to incumbents with a low financial security, we find a similar distribution pattern. However, there are small differences for incumbents with lower financial security who are more likely to keep rather than distribute the proceeds of the sale (25%) compared to high financial security incumbents (22%).

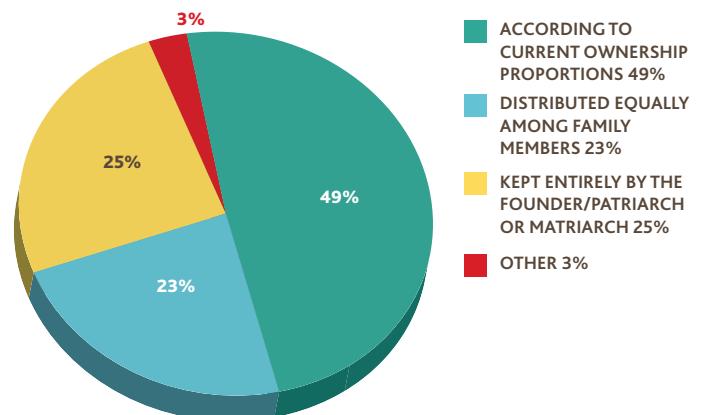
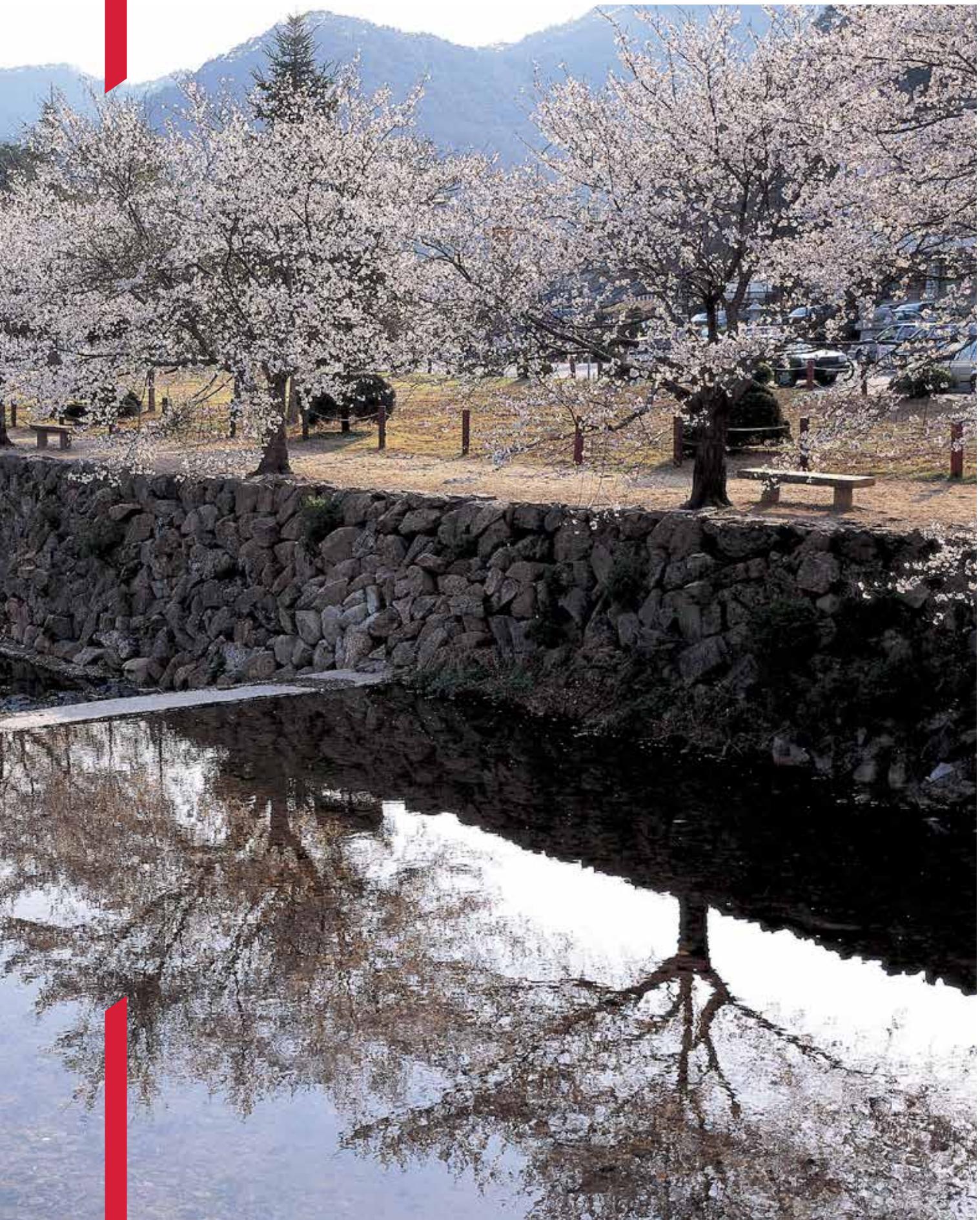


FIGURE 13: DISTRIBUTION OF WEALTH, IF BUSINESS SOLD (INCUMBENTS WITH LOW FINANCIAL SECURITY), IN PERCENTAGE

Irrespective of the level of incumbent financial security, we find that over 70% of respondents indicated that the wealth is to be distributed amongst other parties either equally or in ownership proportions.



Factors to consider

Wealth transfer is impacted by three broad categories of potential factors relating to:

1. The individual incumbent
2. The business itself
3. The beneficiary.

The purpose of the wealth affects these considerations. To date, most emphasis has been placed on how to manage the wealth with little consideration for its purpose.

We address this issue by investigating the implication of wealth diversification for financial freedom of the incumbent. Financially diversified owners will have a different purpose to non-financially diversified owners due to differences in the relative financial freedom.

(1) Individual level

At the *individual* level, incumbents indicated that the financial capacity to retire was the primary motivation behind most wealth transfers. This was closely followed by the internal level of trust the incumbents held for the potential recipients of the transfer. Such considerations rated higher in importance relative to other financial considerations such as tax implications and highlight the importance of building trust across generations to facilitate a more orderly transfer of wealth.

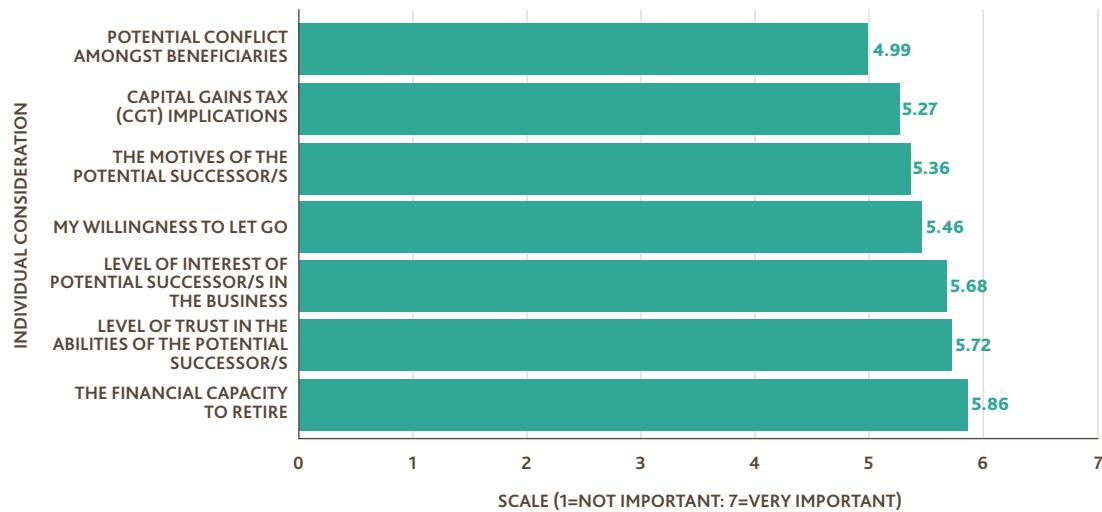


FIGURE 14: AVERAGE RESPONSES FOR INDIVIDUAL-LEVEL CONSIDERATIONS TO TRANSFER WEALTH

"The real hard work is not managing the money. It is figuring out what the money is for. The first choice is to control the wealth for many generations to come, while the second choice is to allow freedom and functionality in future generations".
(Lowenhaupt, 2008)

"At the individual level, the financial capacity to retire was the primary motivation closely followed by the internal level of trust held for the potential recipients of the transfer."

When we differentiate respondents by the degree to which they have invested their wealth *within* the family business or *outside* the family business, we detect some significant differences. The level of interest of the potential successor in the business, and the motives of the potential successor, are of much greater importance for respondents who have invested the majority of their wealth within the family business, in comparison to respondents who have their major wealth invested outside the family business. Similarly, the respondents' willingness to leave, and potential conflicts amongst beneficiaries play a greater role for decision-makers, with most of their wealth invested in the family-business.

Additional complexity arises in situations where there are multiple individuals in one generation of the family firm approaching retirement. Though not directly canvassed in this research, in such instances, transfer discussions are as vital between generations as it is within generations. External factors such as poor performing superannuation fund returns, a depressed real estate market, and flow on effects from the Global Financial Crisis (GFC) are also currently exacerbating deliberations.

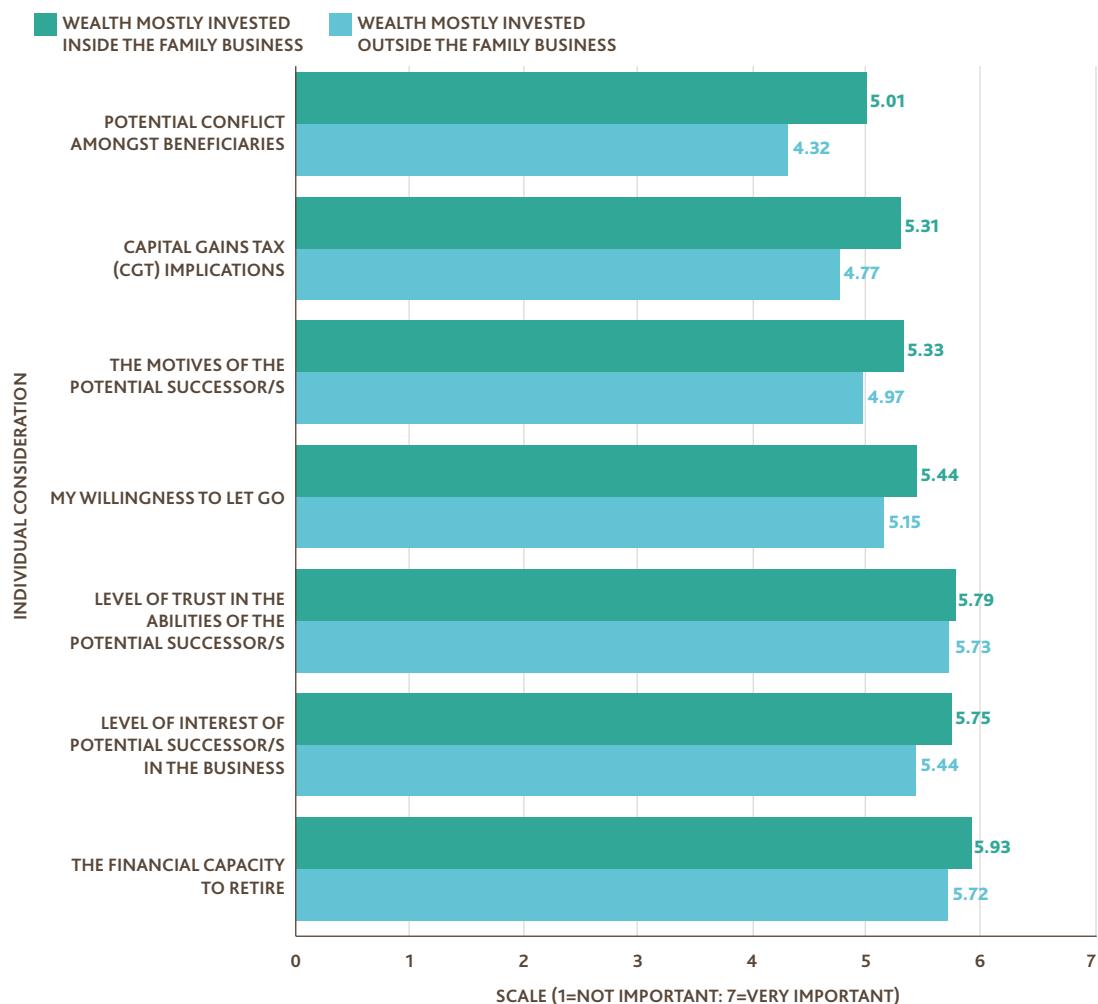


FIGURE 15: AVERAGE RESPONSES FOR INDIVIDUAL-LEVEL CONSIDERATIONS TO TRANSFER WEALTH (WEALTH INVESTED INSIDE VS. OUTSIDE FAMILY BUSINESS)

Other individual level considerations, not canvassed in the survey, include gifting, time payment and dividend policies to facilitate the generational transfer. These are structuring considerations that financial advisers can use to help individuals optimise the cash flow outcomes to suit their needs, as well as tax and other financial implications.

(2) Business level

At the *business* level, perhaps not surprisingly, the business' ability to continue to generate wealth was ranked the most important factor to consider by respondents. This highlights the long-term nature of trans-generational wealth transfer in the sense that the continuation of the business itself, above all other factors, is a primary motivation for wealth transfer.

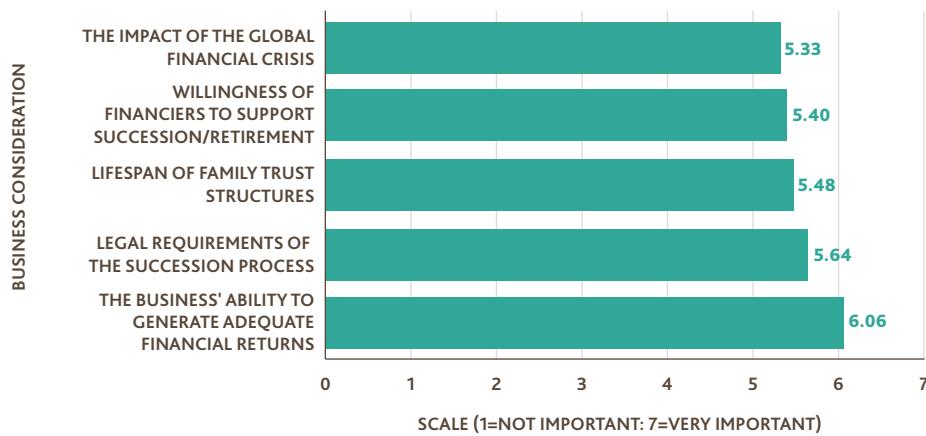


FIGURE 16: AVERAGE RESPONSES FOR BUSINESS-LEVEL CONSIDERATIONS TO TRANSFER WEALTH

The stated importance of generating adequate financial returns indicates that managing the firm effectively is a business priority for family owners. This demonstrates that for family businesses, there is a desire to perpetuate the business for future generations (Gallo & Vilaseca, 1996; McConaughy & Phillips, 1999). This generational investment strategy creates desirable patient capital and evidences an imbedded stewardship culture (Reynolds, 1992).

'Patient capital is financial capital that is invested for long periods without the threat of liquidation. The intended time of investment distinguishes patient capital from the typical financial capital. Patient capital can be a valuable asset for family firms.' (Reynolds, 1992)

"At the business level, the business' ability to continue to generate wealth was ranked the most important factor and for family businesses, there is a desire to perpetuate the business for future generations."

"Additional complexity arises in situations where there are multiple individuals in one generation of the family firm approaching retirement."

If we differentiate according to whether the wealth is invested *within* or *outside* the family business, we can highlight some differences. The willingness of financiers to support the wealth transfer process is of greater importance for respondents that have most of their wealth invested within the family business. Interestingly, the GFC also had a stronger influence on the wealth transfer decision for respondents that have most of their wealth invested within the family business.

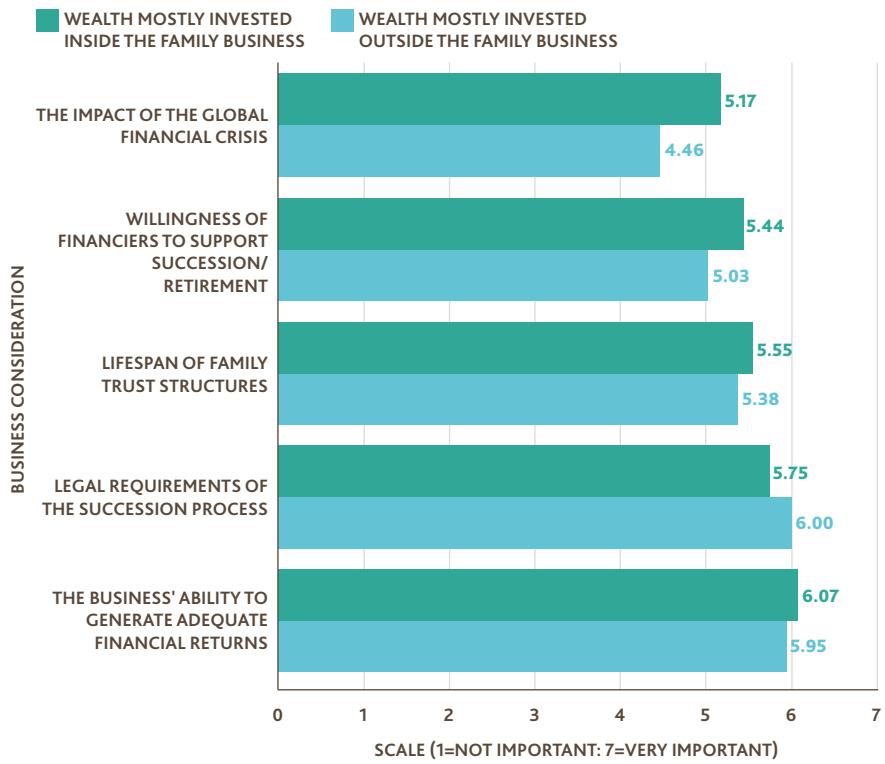


FIGURE 17: AVERAGE RESPONSES FOR BUSINESS-LEVEL CONSIDERATIONS TO TRANSFER WEALTH (WEALTH INVESTED INSIDE VS. OUTSIDE FAMILY BUSINESS)

(3) Beneficiary level

At the *beneficiary* level, general competence and overall education and training are found to be the two most important motivators for wealth transfer. These results are consistent with the fact that the firm's ability to continue generating returns is a primary motivator of wealth transfer and emphasizes the importance of successor preparedness as a main driver of successful wealth transfers (Venter et al., 2005).

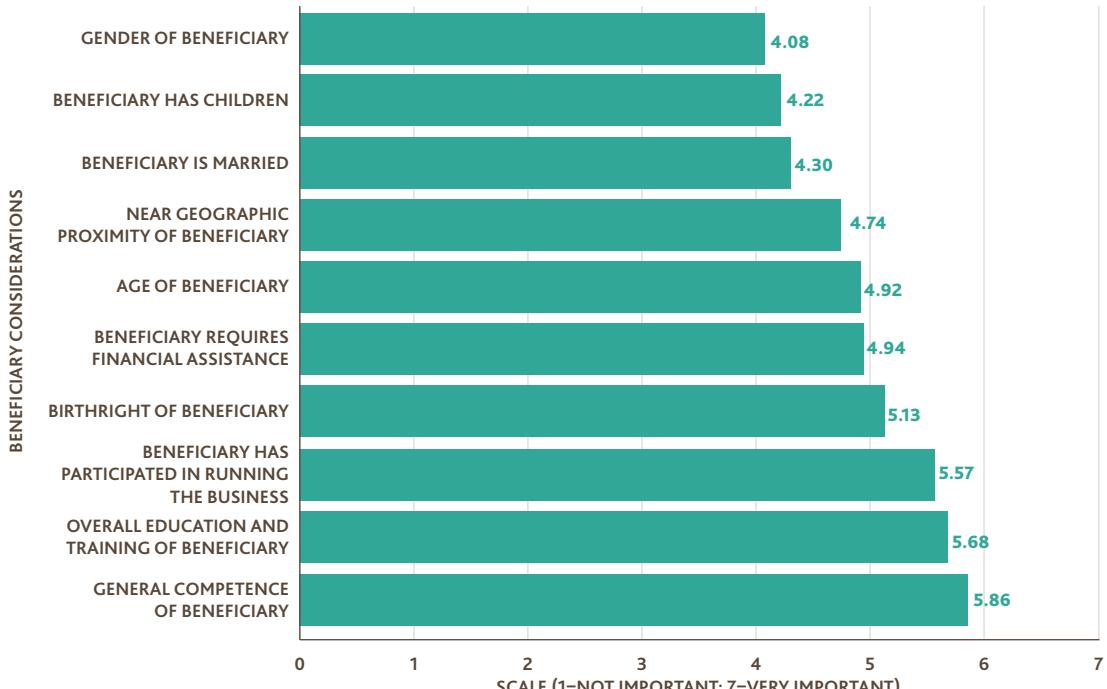
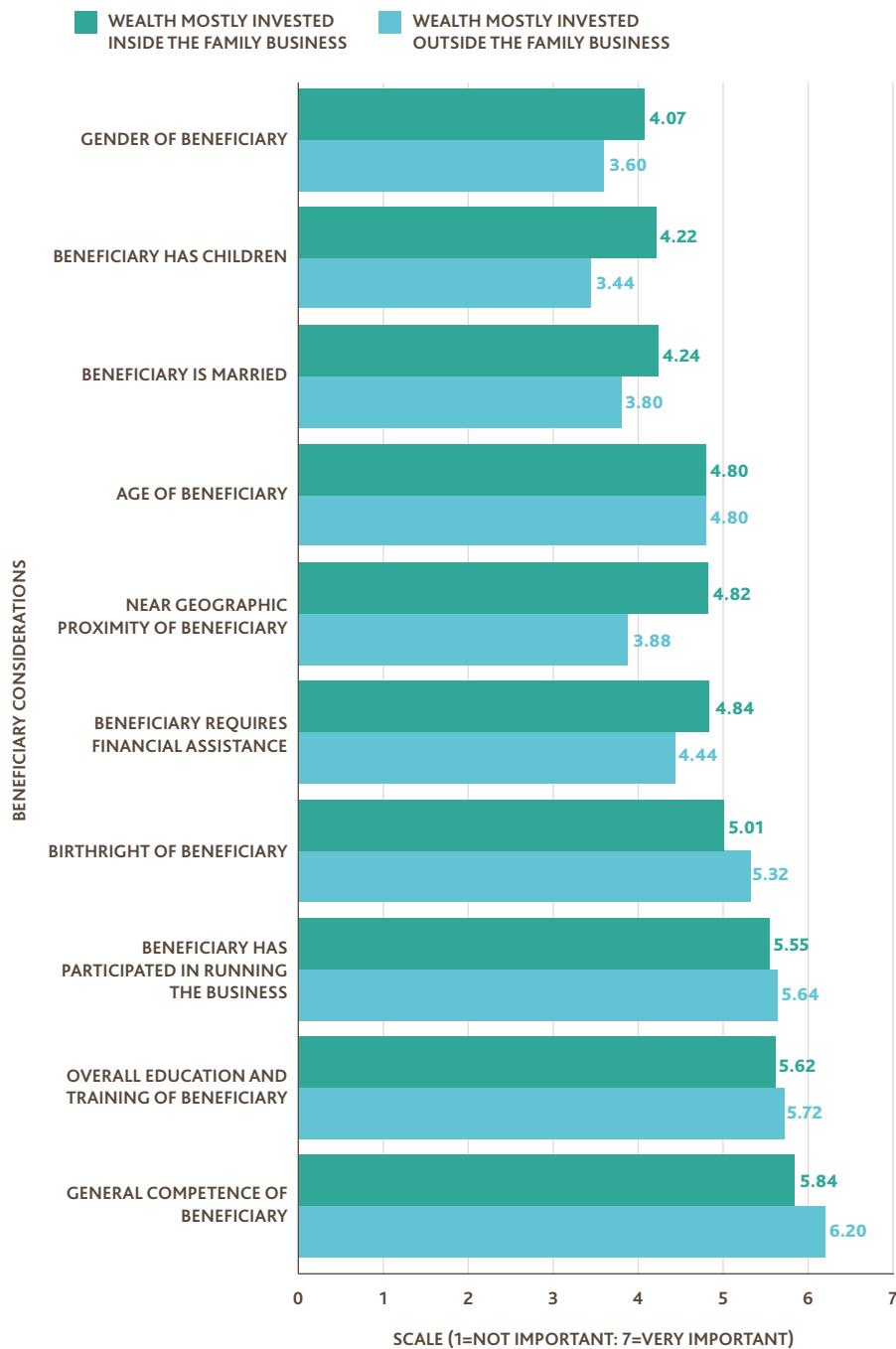


FIGURE 18: AVERAGE RESPONSES FOR BENEFICIARY-LEVEL CONSIDERATIONS TO TRANSFER WEALTH

Differentiating according to wealth invested *inside* versus *outside* the family business, we can see that the near proximity, the marital status, the gender and whether the beneficiary has children is of greater importance for the wealth transfer process for respondents with most wealth invested inside the family business.



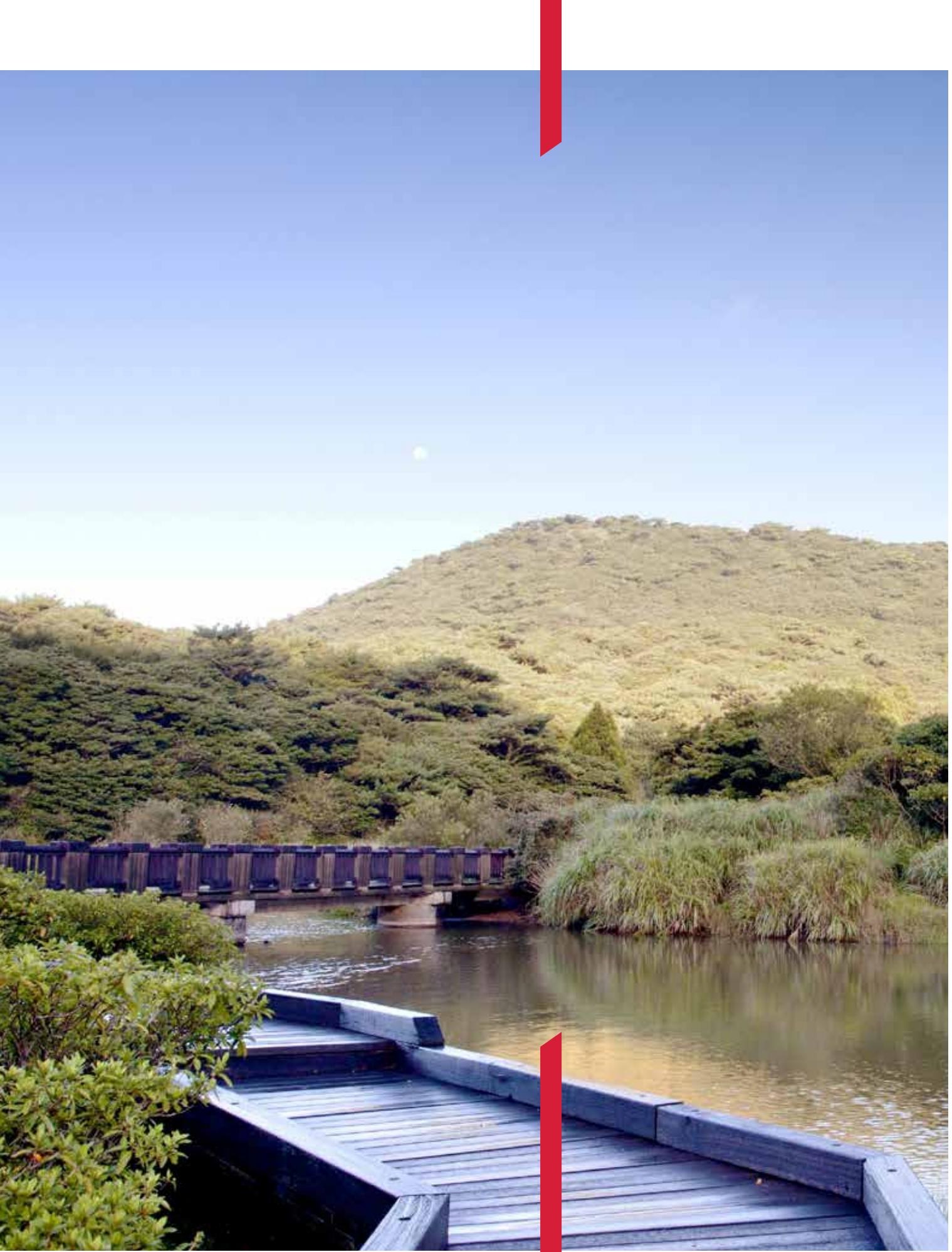
"Evidence suggests soft skills are more important in succession and wealth transfer decisions."

"That is, the successor needs to embody competence with integrity and commitment."

"At the beneficiary level, general competence and overall education and training are found to be the two most important motivators and emphasizes the importance of successor preparedness."

FIGURE 19: AVERAGE RESPONSES FOR BENEFICIARY-LEVEL CONSIDERATIONS TO TRANSFER WEALTH (WEALTH INVESTED INSIDE VS. OUTSIDE FAMILY BUSINESS)

The survey results are consistent with prior research evidence that suggests soft skills are more important in succession and wealth transfer decisions. Chrisman et al. (2004b) find that 'integrity' and 'commitment to business' are the most important attributes of successors. Personal qualities such as the soft skills are more important than gender, age, or birth right. This suggests that successful transition depends on finding a candidate who can be depended on to make a decision that is in the best interest of the business as well as the family. That is, the successor needs to embody competence with integrity and commitment.



Valuing the business for wealth transfer

Another important consideration in the transfer of family firm wealth is knowing how much wealth there is to transfer. However, family business valuations are a complex process for the transfer of family wealth (Gil-Lafuente et al., 2012). The sale and acquisition of family firms do not entail a mere ownership transfer due to the intertwining of the family and the business. The process of valuing a family business is complex and includes a valuation report in order to establish the company value and tender documentation.

Our survey highlights that, despite the prevailing intention of family firm owners to transfer wealth in the near future, 13% of respondents have had formal company valuations less frequently than every six years, and 21% of respondents have never had their company formally valued.

“...despite the prevailing intention of family firm owners to transfer wealth in the near future, 21% of respondents have never had their company formally valued.”

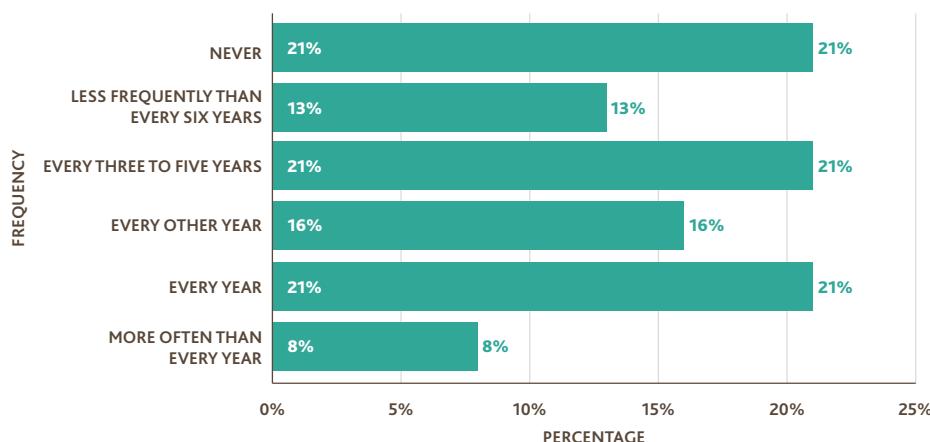


FIGURE 20: FREQUENCY OF REGULAR FORMAL VALUATIONS, IN PERCENTAGE

“In the current challenging times, financiers are expecting more of their private company customers, and fundamental to this changing relationship is a current appreciation of company value.”

"Unique family factors impact the core value drivers used in the balance sheet and income statement based valuation methods."

Furthermore, half of the respondents that have had a formal company valuation in the past have used an outside firm to perform that task. A further 43% of our respondents have used a formula to determine the company value. The four most widely used company valuation methods are balance sheet-based methods, income statement-based methods, mixed methods, and cash flow discounting-based methods (Fernandez, 2007; Hasso & Duncan, 2013). In the current challenging times, financiers are expecting more of their private company customers, and fundamental to this changing relationship is a current appreciation of company value.

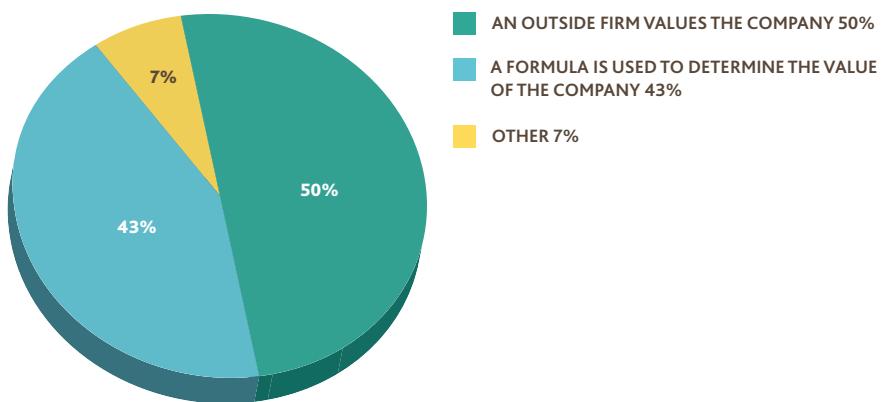


FIGURE 21: TYPE OF REGULAR FORMAL COMPANY VALUATIONS, IN PERCENTAGE

"... and there is a potential for the family firm to be miss-valued."

When we look at the family firms alone, we see that family managed firms are more likely to have frequent valuations (every five years or more often) than professionally managed firms. Furthermore, second and subsequent generation family firms are much more likely to have frequent valuations than first generation family firms.

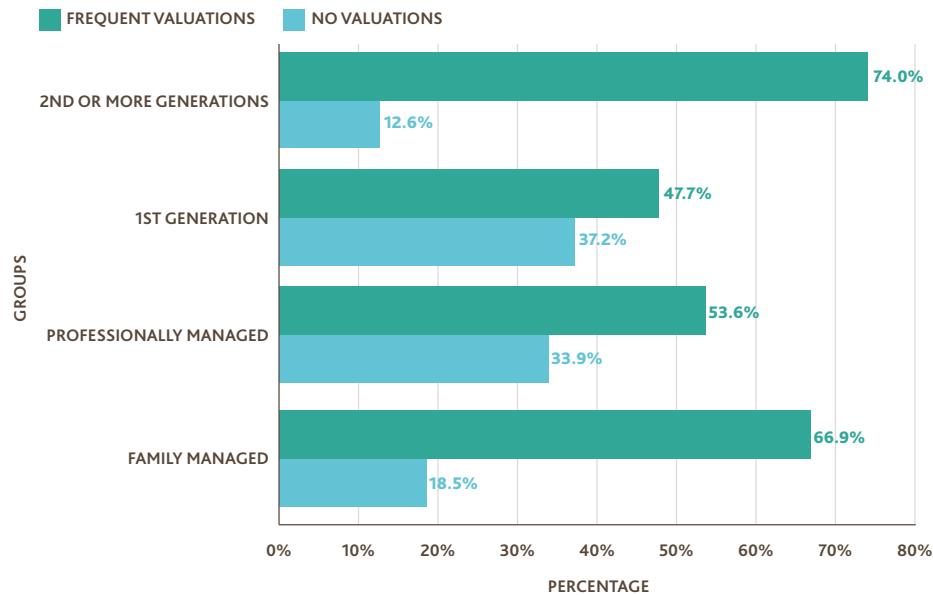


FIGURE 22: VALUATION FREQUENCY FOR PROFESSIONALLY/FAMILY MANAGED AND FIRST/SECOND OR MORE GENERATION FIRMS

A review of the family business valuation literature by Hasso and Duncan (2013) suggests that unique family factors impact the core value drivers used in the balance sheet and income statement based valuation methods. This potentially biases the valuations relative to non-family firms. A key implication is that families in business should engage specialists in the family business domain to advise on business valuation, otherwise there is a potential for the firm to be miss-valued.

Productivity drivers of value

The profitability and value of family firms is different to non-family firms, partly because the labour and capital drivers are different between the two types of firms.

"As a result, long term objectives akin to the continuity of the business, preservation of financial strength and maintenance of family control may receive greater precedence than immediate profits or other short term aims. Such objectives may in turn manifest themselves in the production process. More specifically, in order to meet production demands, family firms may utilise labour and capital in different respects than non-family firms." (Barbera and Moores 2011)

When comparing family with non-family production inputs, namely labour and capital, the survey shows that on average family firms employ fewer workers (labour) and hold less capital (measured by the value of total assets) on their balance sheets. The lower labour and capital employed of family businesses is consistent with Barbera and Moores (2011) who investigated the productivity differential between family and non-family firms, and find that family firms are systematically smaller than their non-family counterparts.

“... long term objectives akin to the continuity of the business, preservation of financial strength and maintenance of family control may receive greater precedence than immediate profits or other short term aims.”

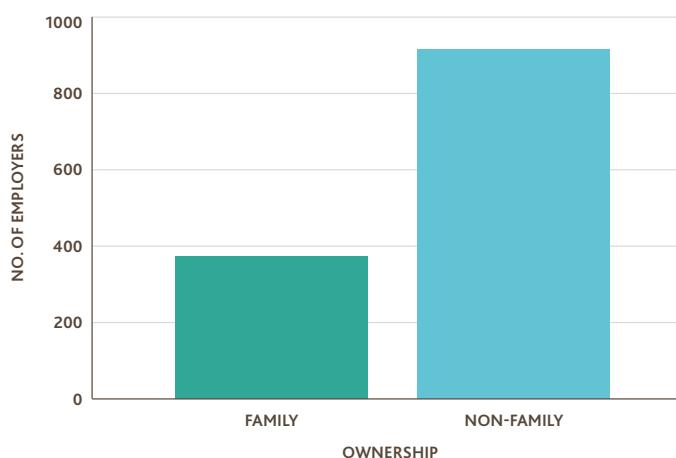


FIGURE 23: LABOUR EMPLOYED (AVERAGE NUMBER OF EMPLOYEES)

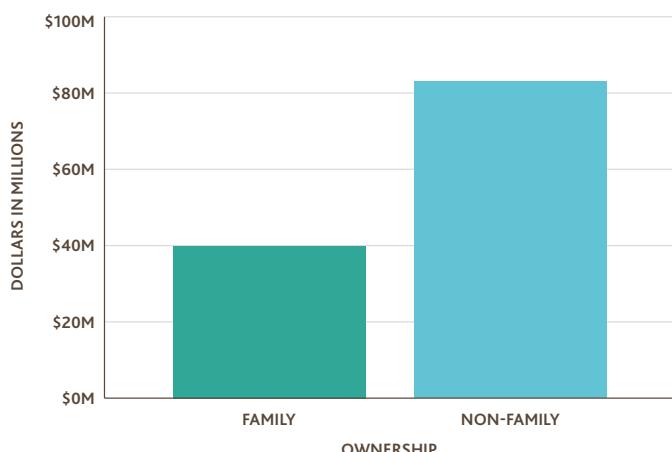


FIGURE 24: CAPITAL EMPLOYED (AVERAGE \$ MILLION TOTAL ASSETS)

The proportion of part-time workers to the number of all workers employed in any given firm (i.e. the 'part-time ratio') provides insight into the preferred labour type, part-time or full-time.

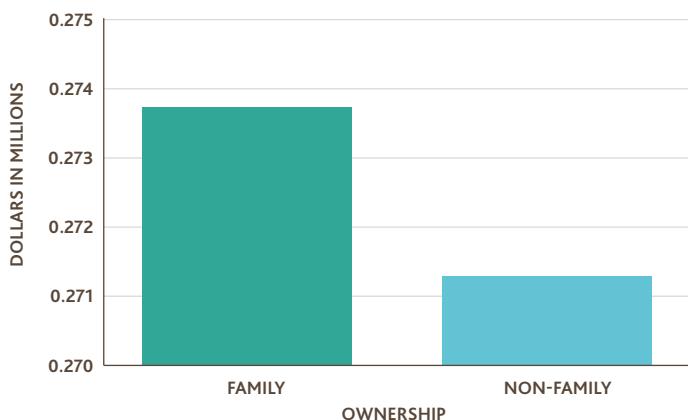


FIGURE 25: PART-TIME TO FULL-TIME LABOUR RATIO

This analysis demonstrates that family firms utilise (slightly) more part-time workers than non-family firms. One explanation would be that family firms initially associate offspring with the firm through family discussions or part-time employment (Stavrou 1999). These results may also underpin the flexible labour arrangements enjoyed by family firms discussed in Barbera and Moores (2011).

"... the output contribution of both family firm labour and capital, when considered as heterogeneous production factors to those of non-family firms, may also be different... the notion that family firm labour and capital inputs yield exactly the same contribution toward output as non-family firm labour and capital may be flawed, and thus treating them as equal theoretically and empirically could be a mistake. Based on the literature to date, it is possible that family involvement may have both positive and negative effects on production inputs."

(Barbera and Moores 2011)

We compare the average sales per worker and asset turnover (sales to total assets) between family and non-family firms to explore the productivity of both labour and capital.

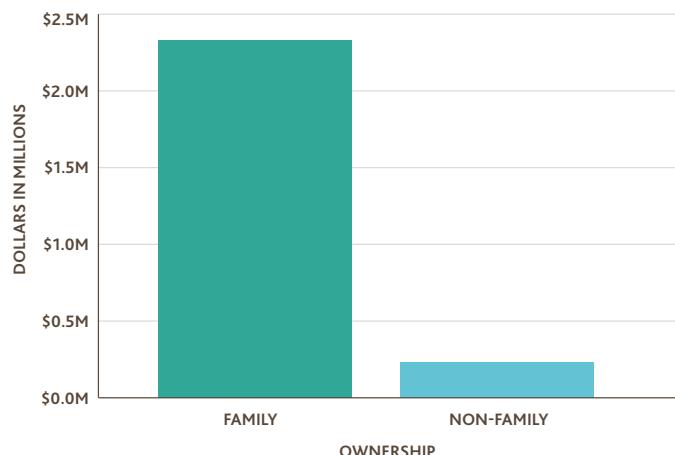


FIGURE 26: LABOUR CONTRIBUTION TO SALES (AVERAGE \$ SALES PER EMPLOYEE)

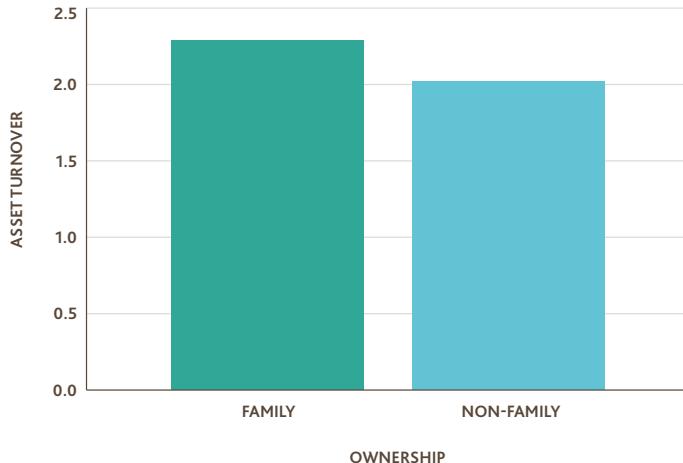


FIGURE 27: ASSET CONTRIBUTION TO SALES (AVERAGE \$ SALES PER \$ ASSETS)

The analysis above demonstrates that family firm inputs are more productive (in terms of generating sales) than non-family firms. Family labour contributes much more towards sales than non-family labour, while family capital is only slightly greater. This gives credence to the findings of Barbera and Moores (2011), who also report that family labour contributes more to output relative to non-family labour. This also supports the proposition of Hasso and Duncan (2013), that the relationship between value and performance for family firms is fundamentally different.

Financial performance and risk

Hasso and Duncan (2013) show that family business literature has identified a number of factors underpinning the performance, risk and therefore value differences of family firms. A key factor is the long term orientation of the family with respect to the family wealth invested in the business. The analysis below compares the sales performance and perceptions of relative performance to competitors of first, second or more generation firms.

"A key factor underpinning the performance, risk and therefore value differences of family firms is the long term orientation of the family with respect to the family wealth invested in the business."

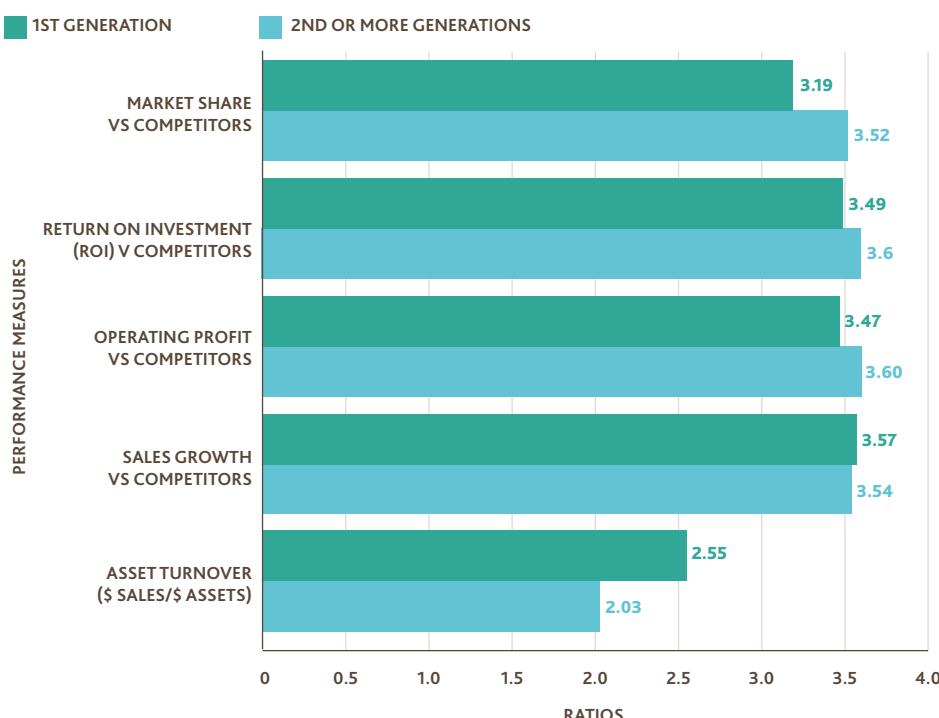


FIGURE 28: COMPARATIVE PERFORMANCE OF FIRST VERSUS MULTI-GENERATIONAL FIRMS

"A related issue for families in business is the risk exposure via personal guarantees for family business debts. Over 64% of first generation firms have debt guarantees for company debts."

First generational firms demonstrate higher asset efficiency, with more sales per dollar of assets in place. This could simply reflect that younger firms are leaner and work their assets harder than older firms that have more asset 'fat' in the system.

First generation firms also perceive their sales growth versus competitors slightly more positively than second or more generation firms. Multi-generational firms perceive that relative to competitors, they have higher operating profits, ROI and market share than perceived by first generational firms. These perceived differences, however, are not that large.

What is more significant is the difference in level of financial risk (debt/equity) for first versus multi-generational firms. This is consistent with McConaughay et al. (2001) who show that family firms use significantly less debt with the difference even greater with respect to the use of short-term debt. In contrast, family firms that use control enhancing mechanisms are more leveraged (King & Santor 2008) and in periods of growth, family firms use more debt capital (Schulze et al. 2003). Other family firm research uses the level of leverage as a proxy for risk-aversion. Gomez-Mejia et al. (2007) found that while family firms are risk-averse when it comes to accepting venturing risks, they are willing to accept more performance hazard risk to secure socio-emotional wealth. The conflicting results need to be explored to learn more about the use of debt in the capital structures of family firms

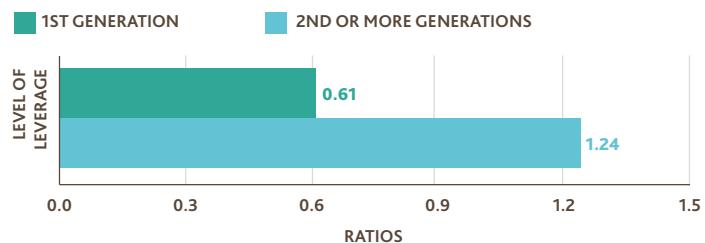


FIGURE 29: FINANCIAL RISK - DEBT TO EQUITY

A related issue for families in business is the risk exposure via personal guarantees for family business debts. Over 64% of first generation firms have debt guarantees for company debts but only 54% of second or more generation firms had guarantees. A similar pattern is found for firms with greater than median debt levels (defined as high debt to equity). However, a greater proportion (16% versus 10%) of multi-generational firms with high debt to equity did not have guarantees in place. About 40% of both first and multi-generational firms were looking to change the guarantees in the near future as part of the succession process.

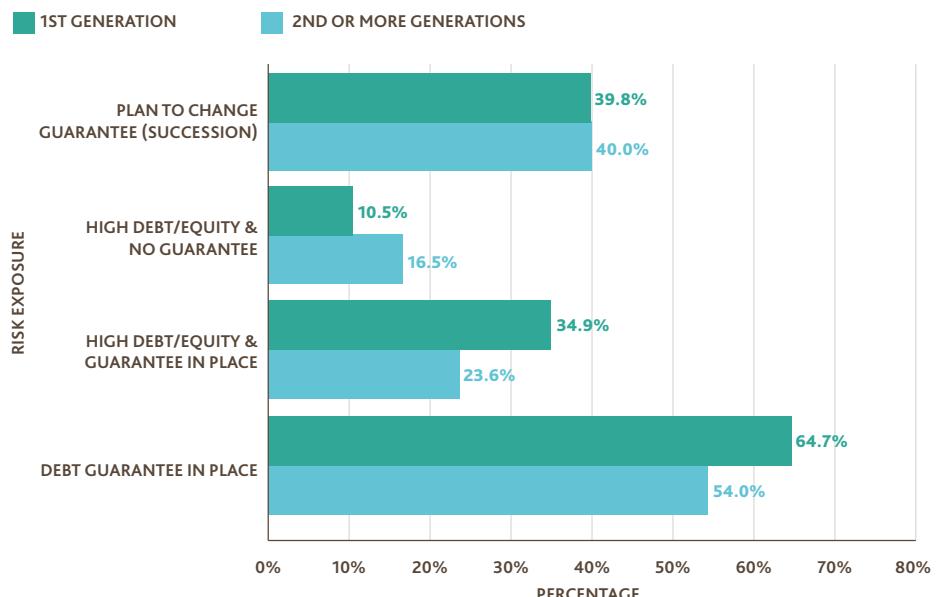
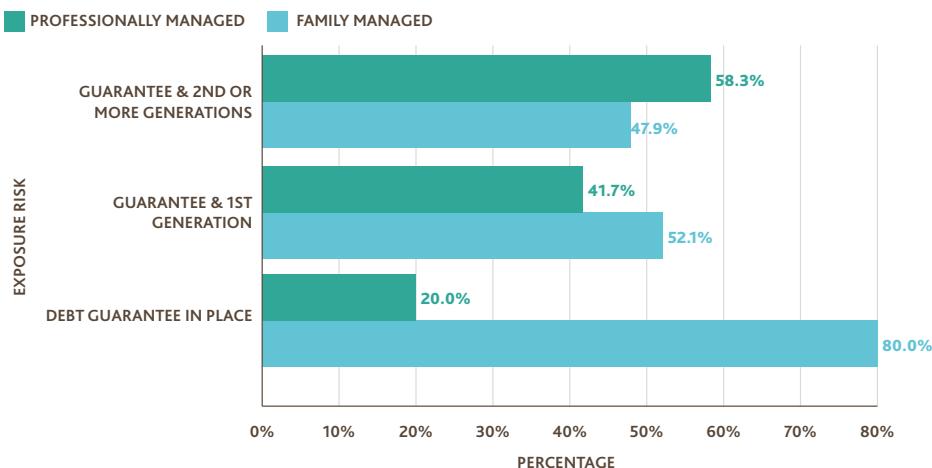


FIGURE 30: DEBT GUARANTEE AND RISK

When we look at professionally managed versus family managed firms, it is clear that family managed firms are much more likely to have debt guarantees. This suggests that family firms are higher risk in terms of their perceived governance risk but may also reflect the lower assets of family firms and higher skill set of professional managers. However, we find professionally managed family firms are more likely to have guarantees if they are a multi-generational firm, rather than a first generation firm.



"We find that professionally managed firms have higher actual sales turnover and perceive they have higher sales growth, operating profits, ROI and market share than their competitors."

FIGURE 31: DEBT GUARANTEES, PROFESSIONALISATION AND MULTI-GENERATIONAL FIRMS

Finally, relative to family managed firms, we find that professionally managed firms have higher actual sales turnover and perceive they have higher sales growth, operating profits, ROI and market share than their competitors. Professionally managed firms have slightly lower debt equity and thus less financial risk than family managed firms.

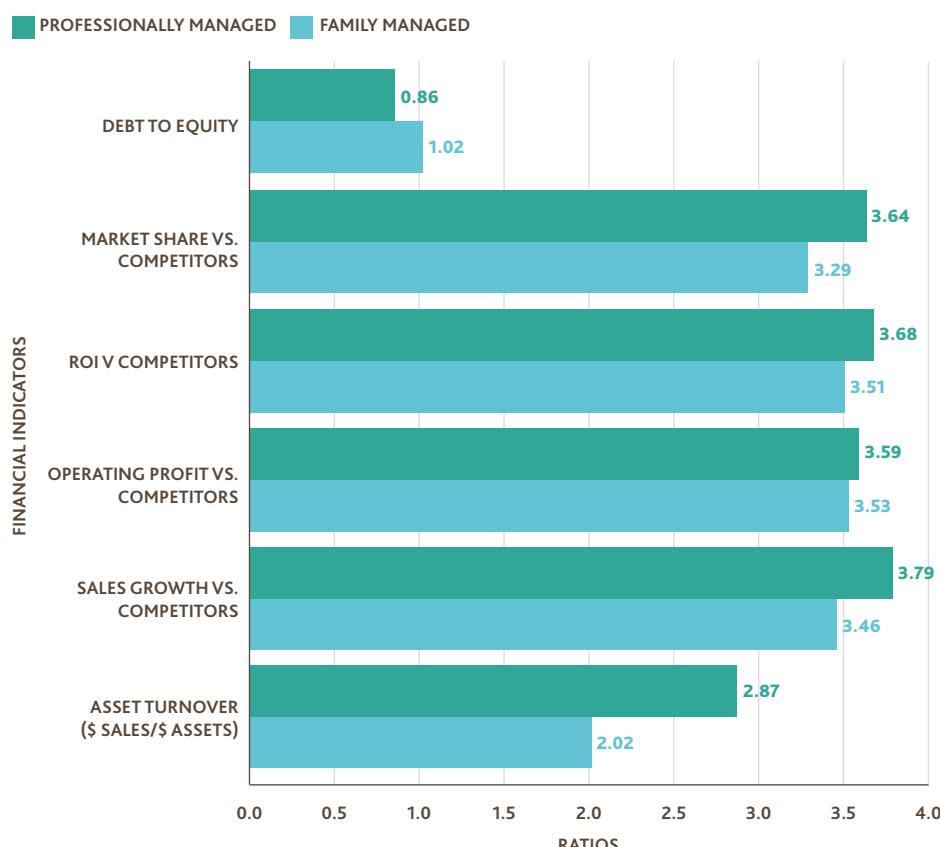


FIGURE 32: COMPARATIVE FINANCIAL PERFORMANCE AND RISK FOR PROFESSIONALLY VS. FAMILY MANAGED

These findings are consistent with Hasso and Duncan's (2013) argument that while the:

“...literature suggests that family firms are systematically different from non-family firms and that these differences are value enhancing ...the unresolved question is how information about the family factors and their implication for firm performance and hence value is captured and transmitted to decision makers”. (Hasso & Duncan, 2013)

The process of valuing a family business requires different knowledge and skills to other forms of business. A skilled family business valuer can factor in the differences in risk and performance, and thus provide more appropriate valuation estimates.

In addition to the *individual, business, beneficiary* considerations and the process of valuing the business, for successful wealth transfers there is a parallel process of preparing and learning to 'let go' of the business.



Transfer preparedness – ‘learning to let go’

“Only 39% of the family businesses surveyed have a complete succession plan that nominates a CEO successor.”

‘Learning to let go’ is not so much an event as a process of transition. In the first stage, the incumbent family business leader has to consider whether the business should be sold and to whom. Where the decision is made to retain the business in the family, the question arises as to what qualities the new leader will need and how to develop and nurture the successor. Ultimately, the ‘learning to let go’ stage culminates in planning the wealth transfer process. A successful transition plan needs to incorporate a formal succession plan and the selection of a best qualified CEO successor. The transitioning of ownership and management along with the development of the successor is critical for the successful transition of the family business. For the incumbent leader, it is essential to plan his/her retirement in order to be financially independent and able to ‘let go’.

Succession plan

Family businesses are typically not good at planning the succession process simply because they do not do it very often. The typical tenure of a leader of a family owned business is 20 years, whereas, in public companies, CEOs are in their position for usually less than seven years. Regardless, in family businesses, due to the close association to the business, CEOs are usually reluctant to step down (Ocasio, 1994). In addition, unanticipated and poorly managed successions can have a negative effect on shareholder wealth (Beatty & Zajac, 1987). Importantly, recent evidence highlights that business owners who plan their succession arrive close to retirement with much higher wealth levels and display higher financial literacy than non-planners (Lusardi & Mitchell, 2007).

For a successful transition to occur there needs to be a formal succession plan developed, committed to, and implemented. The best qualified CEO successor needs to be selected and mentored in preparation for the challenges of leadership. Alarmingly, only 39% of the family businesses surveyed have a complete succession plan that nominates a CEO successor.

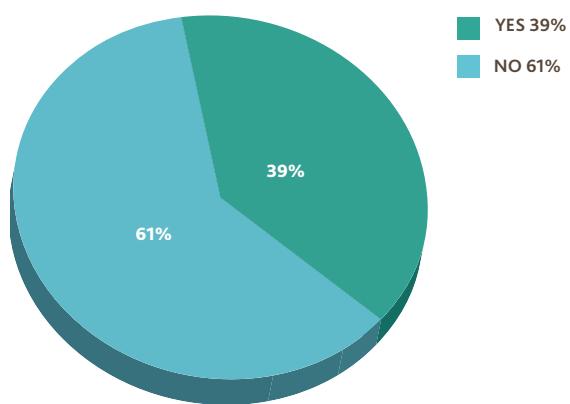


FIGURE 33: EXISTENCE OF A FORMAL SUCCESSION PLAN WITH NOMINATION OF A CEO SUCCESSOR, IN PERCENTAGE

Nominating a CEO successor

We found that the most sophisticated succession plans came from those firms in which a formal succession plan has been installed and the successor has been selected. Of those firms that currently hold incomplete succession plans, where they have installed a formal succession plan, but failed to name a successor, the sophistication of the succession plan was lower than all firms with complete plans.

"If the named successor was a family member, the sophistication of the succession plan was noticeably reduced."

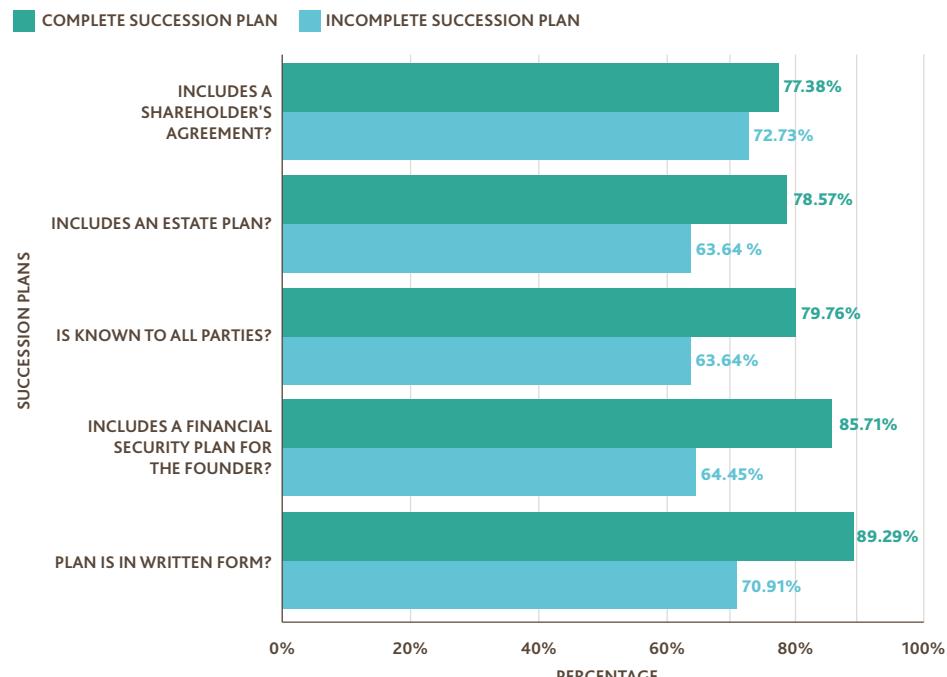


FIGURE 34: COVERAGE OF COMPLETE (FORMAL & CEO SUCCESSOR) VS. INCOMPLETE PLAN (NO CEO SUCCESSOR SELECTED), IN PERCENTAGE

Furthermore, if the named successor was a family member, the sophistication of the succession plan was noticeably reduced. Different priorities take precedence, such as having a financial security plan for the incumbent/founder and having the plan in written form.

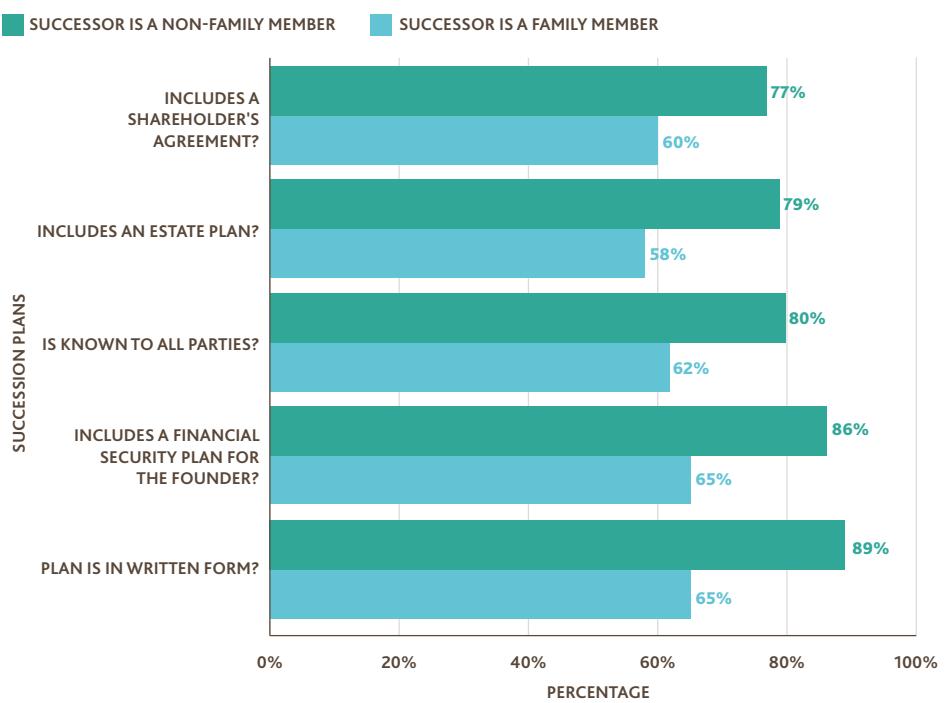
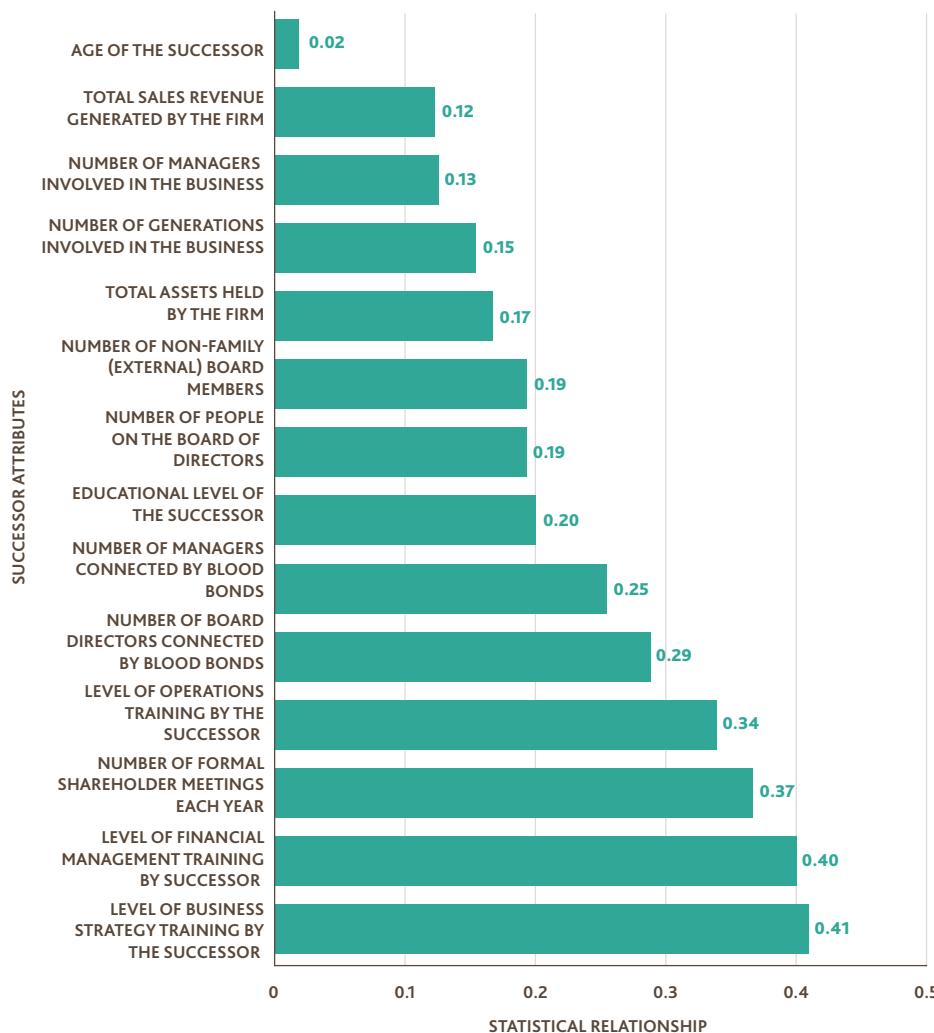


FIGURE 35: PLAN COVERAGE IF SUCCESSOR IS FAMILY MEMBER VS. SUCCESSOR IS NON-FAMILY MEMBER, IN PERCENTAGE

With varying strengths, the degree of sophistication observed in the succession plans for all family firms was significantly and positively correlated with certain firm and successor attributes.





"Multi-generational firms are more likely to have a completed succession plan."

FIGURE 36: CORRELATION BETWEEN PLAN SOPHISTICATION WITH FIRM AND SUCCESSION ATTRIBUTES

Multi-generational firms are more likely to have a completed succession plan, and are more likely to exhibit a higher degree of sophistication.

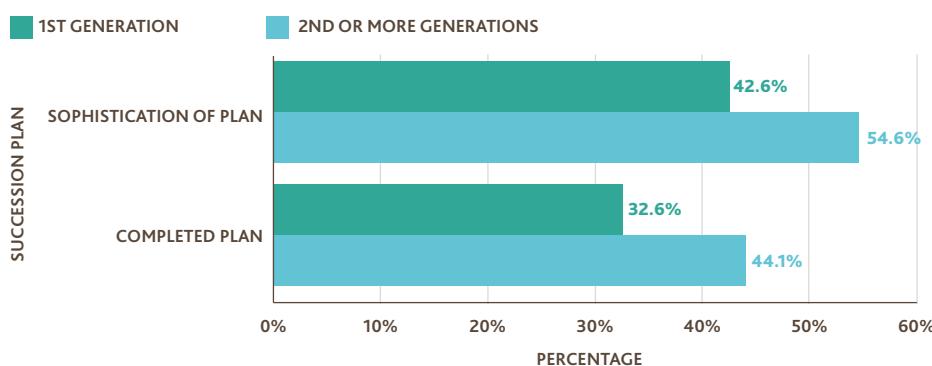


FIGURE 37: FORMALITY AND SOPHISTICATION OF 1ST VS. MULTI-GENERATIONAL PLANS

The level of plan sophistication is also likely to be related to key indicators of the family businesses in terms of management, governance structures, and processes.

"One indicator of a family business' propensity to let go is the degree of professionalisation of the firm."

Professionalising management and governance

One indicator of a family business' propensity to let go is the degree of professionalisation of the firm. This can be at two levels: (1) professionalising the management and (2) professionalising the governance. Professionally managed firms are those where non-family members comprised of more than 50% of the management team and professionally governed firms are those where outsiders comprised more than 50% of the board of directors. The professionalisation of management and governance is expected to facilitate the orderly transfer of wealth, however, family firms appear to be slow in professionalising.

"Despite direct and indirect arguments in favour of professionalisation, a great many family firms fail to follow this prescription." (Stewart & Hitt, 2012)

The survey data is in line with the literature. We find that about 27% of firms are professionally managed, and 21% are professionally governed. That means less than a third of firms have 'let go' of control of the management team, and similarly less than a quarter of family businesses have let go of board control.

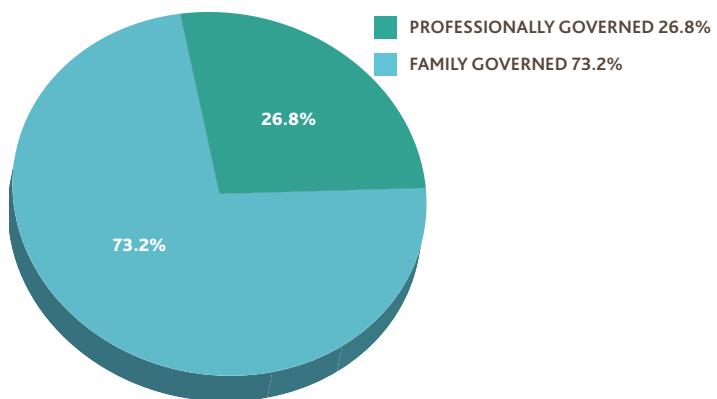


FIGURE 38: PROFESSIONALISATION OF FIRM MANAGEMENT

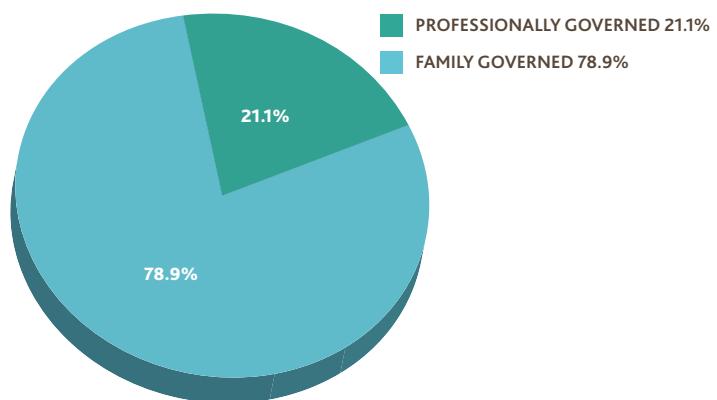


FIGURE 39: PROFESSIONALISATION OF FIRM GOVERNANCE

When we consider professionalisation practices on a continuum, we can see that the majority of the family firms are both family managed and governed (64%). About a quarter of firms surveyed are in transition, in that they have either professionalised their management or their governance but not both. Only 12% of firms surveyed have professionalised both their management and governance structures.

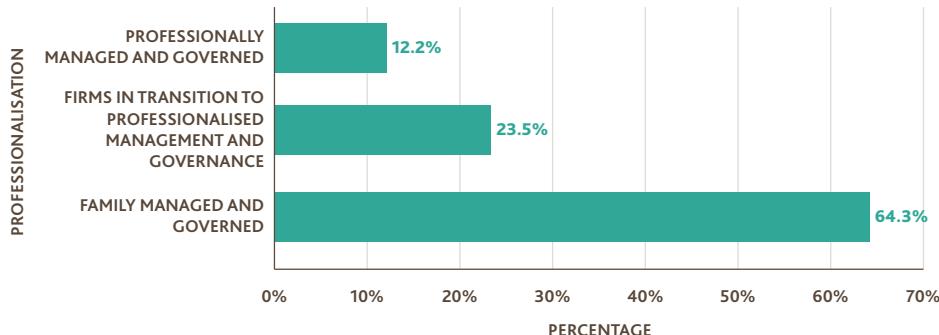


FIGURE 40: DEGREE OF PROFESSIONALISATION

The degree of professionalisation of the firm, both in terms of management and governance, impacts the propensity to nominate a non-family member as successor to the CEO. Professionally managed firms are more likely to nominate a non-family successor, while family managed firms tend to look to the family pool for potential successors. The same is also true for family governed firms. In a professionally managed and governed firm there is a lower propensity for nepotism to influence successor decision making. In family managed and governed firms, having a valuable idiosyncratic knowledge of family members is a relevant factor and this influences whether or not the nominated successor will be a family member.

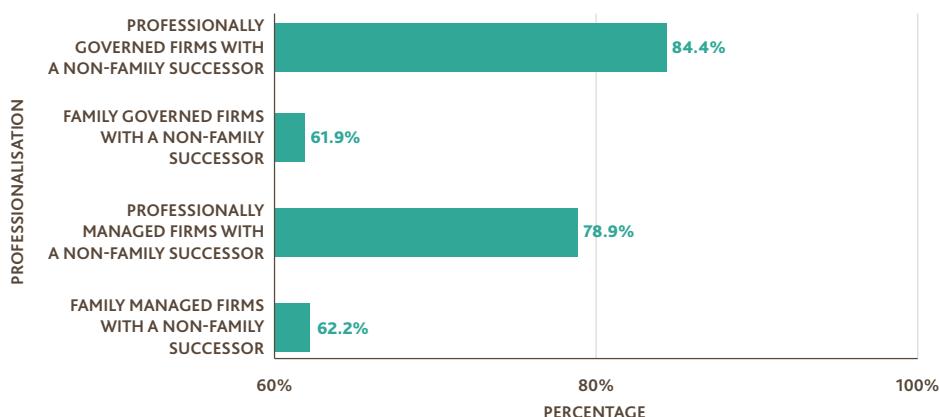


FIGURE 41: DEGREE OF PROFESSIONALISATION AND NON-FAMILY SUCCESSOR

Part of being able to '*let go*' of the business is the ability to draw on behavioural skills to manage co-operatively. One of the paradoxes in family business is that a competitive conflict management style is the typical behavioural skill required to build the business, especially for founders. However, competitive conflict is found to be negatively associated with formal succession planning (Marshall et al., 2006). Professionalising the management and governance indicates an ability of the incumbent to manage co-operatively which is found to be positively associated with succession planning and '*learning to let go*'.

The survey measured three specific indicators of professionalisation such as the implementation of strategic planning, transparency, and delegation of authority by the CEO. Irrespective of the measure used we find that professionalised firms are more likely to have a formalised succession plan. Specifically, firms with a strategic planning process, a higher frequency of shareholder meetings (increased transparency) and more delegation of authority by the CEO, are more prepared to let go of the business.

"Only 12% of firms surveyed have professionalised both their management and governance structures."

"The survey measured three specific indicators of professionalisation such as implementation of strategic planning, transparency, and delegation of authority by the CEO. We find that professionalised firms are more likely to have a formalised succession plan."

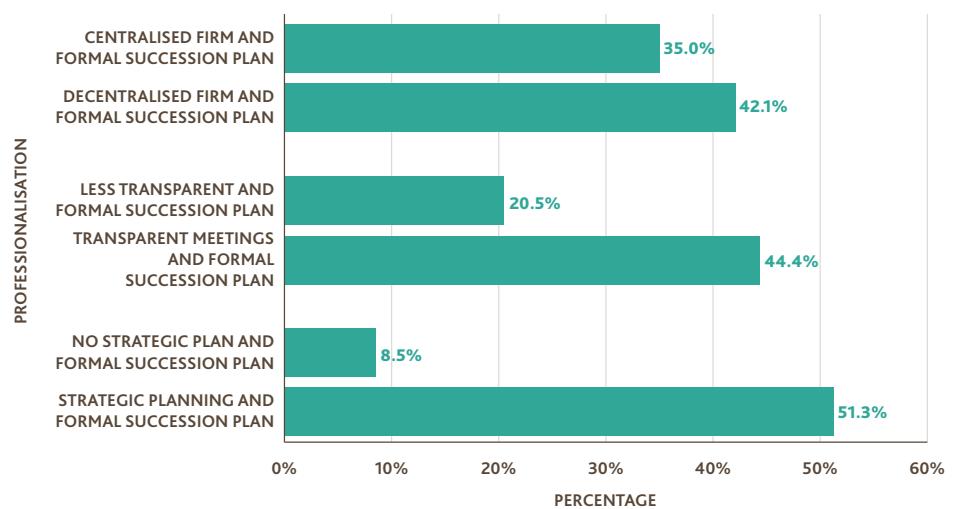


FIGURE 42: PROFESSIONALISED FIRMS AND SUCCESSION PLANNING

“Businesses are recognising that one of the most valuable assets is their business know-how, which is a core intangible asset of the business. Not recognising this is a significant risk factor that potentially could undermine the businesses success and continuity.”

Family businesses, especially in the first generation, are reluctant to professionalise the firm because of the imbedded culture of independence and family identity within the firm (Poza, 2007). Although management style does not appear to be significantly different across the generation of the business, the survey results for the strategic planning and transparency dimensions are consistent with this observation.

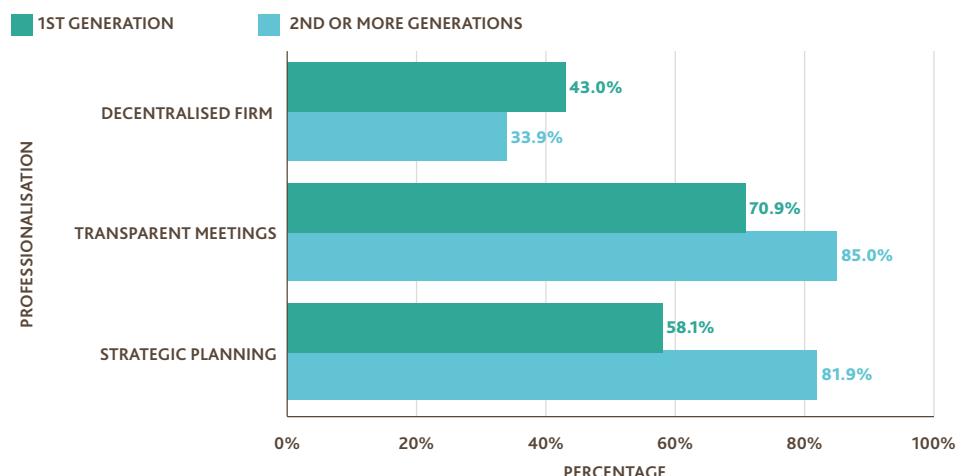


FIGURE 43: PROFESSIONALISATION ACROSS GENERATIONS

Knowledge transfer

A key element in preparing to let go of the business, and thus the implementation of a successful transfer of wealth, is the process of knowledge transfer. Businesses are recognising that one of the most valuable assets is their business know-how, which is a core intangible asset of the business. Professionalisation of the business to capture the knowledge both tangible and intangible is a key success factor for multi-generational businesses. Not recognising this is a significant risk factor that potentially could undermine the businesses success and continuity.

Family business succession not only entails the transfer of wealth, but also the transfer of knowledge to the successor management team (Cabrera-Sua’rez et al., 2001). The process of knowledge transfer involves both tangible and intangible knowledge and is transferred from the incumbent to the successor through the stages. The 4L framework is a useful tool to think about the knowledge transfer process and the foundation upon which it is built for a family business. The 4L framework depicts the last stage of ‘learning to let go’ to be built upon the foundations of three earlier stages of ‘learning business’, ‘learning the family business’ and ‘learning to lead the family

business'.

'Learning business'

A first step in any organisation and management team is learning the basics of business. The same applies to future family business owners. They need to learn the core knowledge and skills of business and management. Moores and Barrett (2010) endorse the need for a broad-based formal education for future business owners, and not necessarily in business. Future business owners need to learn the general skills such as self-management skills, people skills, practical knowledge, and how to learn to be a lifelong learner. Secondary and tertiary education put these basic building blocks in place for future potential family and family business leaders.

Approximately 40% of the surveyed respondents nominated a successor. For those firms with a nominated successor, we found that the majority have tertiary qualifications indicating that the basics of learning and learning business have been addressed in selecting nominated successors.

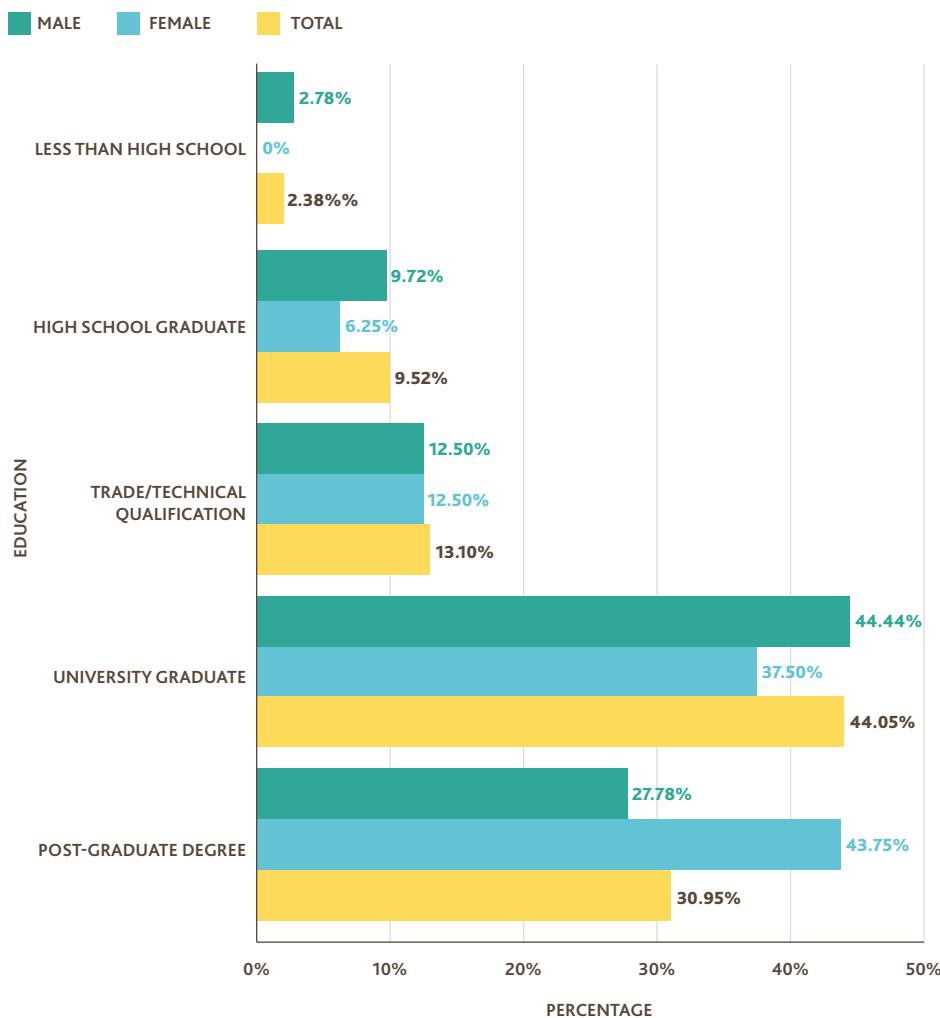


FIGURE 44: SUCCESSOR EDUCATION LEVEL AND GENDER

The rate of education participation is higher than the national average of approximately 30%, which indicates that these family businesses have invested in building the educational base within the family. The survey suggests that the investment in education is more prevalent for female rather than male successors.

Formal education alone is not sufficient for anyone to be a business leader. There are many aspects to learning business including (1) people management, (2) self-management, (3) innovation and (4) operations management. Gaining a broad knowledge of the industry at a technical level is also best done early and outside the firm through practical work experience. The skills learnt while working outside the family business, where family relationships do not 'cloud the scene' allow potential successors to develop their own identities and learn the discipline needed to run a business.

"Approximately 40% of the surveyed respondents nominated a successor, we found that the majority have tertiary qualifications."

"The rate of education participation is higher than the national average of approximately 30%, the survey suggests that the investment in education is more prevalent for female rather than male successors."

A family business successor, whose family required him to work outside the firm, provides a valuable insight: "it was important for me to learn how to work for a boss."

This 'inside-outside' dimension to acquiring the basics of business knowledge is at the heart of the contradiction about learning (transferring knowledge) family business which Moores and Barrett (2010) called the 'inside-outside' paradox. 'Going outside' the family business provides vital learning opportunities to develop new skills and broader perspectives not readily available within the family business. This also allows the family member to prove themselves worthy of career progression and promotion into senior management roles, an important pathway in order to 'return inside' the family firm. Herein lies the paradox that the family member may choose not to return to the family business, and thereby threaten the survival of the firm as a family firm.

With respect to 'outside' work experience, the survey shows that most successors have spent five or more years working outside the firm.

"The data in this survey shows that 82% of all nominated successors are males. Female business owners in family business find themselves taking over the business by default, rather than consciously directing themselves towards the CEO position."

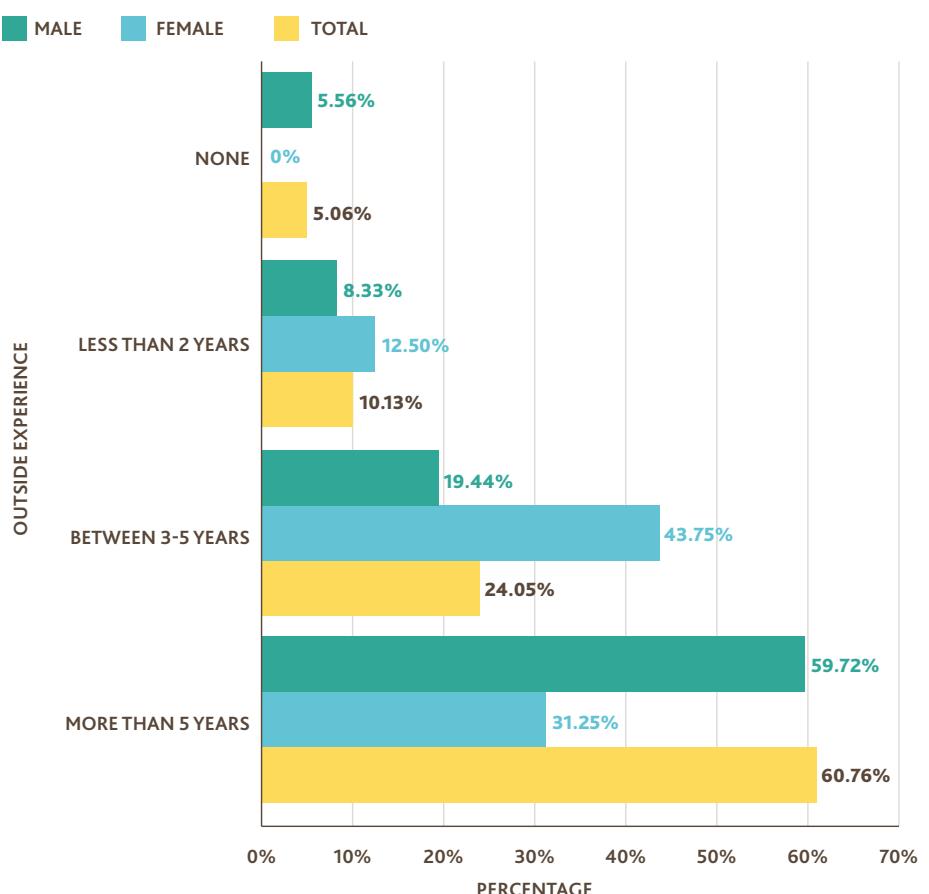


FIGURE 45: SUCCESSOR OUTSIDE EXPERIENCE BY GENDER

In contrast to the results for level of education, nominated female successors have spent less time working outside the firm than their male counterparts, however, they have higher levels of educational qualifications. Both genders are proving themselves and earning the right of passage to succession but in different ways. One path is more educationally based and the other is more experience based. Despite this, females were not thought of as the logical choice for the top job in the same way as men who had gone outside the firm and then returned to it. The data in this survey shows that 82% of all nominated successors are males. Female business owners in family business find themselves taking over the business by default, rather than consciously directing themselves towards the CEO position.

Whether by formal education, or by outside work experience, learning about business outside the family business helps to form a solid foundation for learning about the unique aspects of the family business.

'Learning the family business'

Learning general business skills is not sufficient to be able to successfully manage the family business. The potential successor generation also needs to learn the family business. There is something about learning family business that is different from learning business in general. Family leaders have specific family business knowledge to transfer and need to spend time with the successor. Often, this is knowledge based on tradition, part of '*the way we do things around here*', and it involves capturing '*the stories that explain why we do things the way we do*' and in that sense unique to the firm. Future leaders need to acquire a set of attitudes and values from the family leaders in the business and a range of other people. The successor must integrate the knowledge transferred by the predecessor in family and professional contacts (family meetings, management team meetings, and so on) with the knowledge acquired during his or her training (Habbershon & Williams, 1999).

It is the intangible resources that enhance the uniqueness of family firms (Habbershon & Williams, 1999; Sirmon & Hitt, 2003). Networks are among the intangible resources that can generate a competitive advantage and thus make family firms unique (Hall, 1992).

"Networks provide value to members by allowing them access to the social resources embedded within the network; that is, networking can provide the means by which small and medium enterprise (SME) owners can tap needed resources that are 'external' to the firm. [...] This form of cooperation can facilitate the achievement of economies of scale in small firms without producing the diseconomies caused by large size. Using networks can, therefore, potentially lower a firm's risk of 'failure' and increase its chances of 'success'" (Watson, 2007).

The survey assessed the degree of interaction with various types of contacts and networks of the family business by the incumbent. These are the contacts and networks that any successor will have to develop and maintain relationships with in order to successfully learn how the family business works. Ranked highly on the list were customers, family members, suppliers and financial institutions. Lower on the list were competitors and external board members. Multi-generational firms have greater interaction with contacts of the family business, suggesting that these networks are more complex requiring more skill to maintain.

"Family leaders have specific family business knowledge to transfer and need to spend time with the successor. Often, this is knowledge based on tradition, part of '*the way we do things around here*', and it involves capturing '*the stories that explain why we do things the way we do*' and in that sense unique to the firm."

"The survey assessed the degree of interaction with various types of contacts and networks of the family business by the incumbent in order to successfully learn how the family business works."

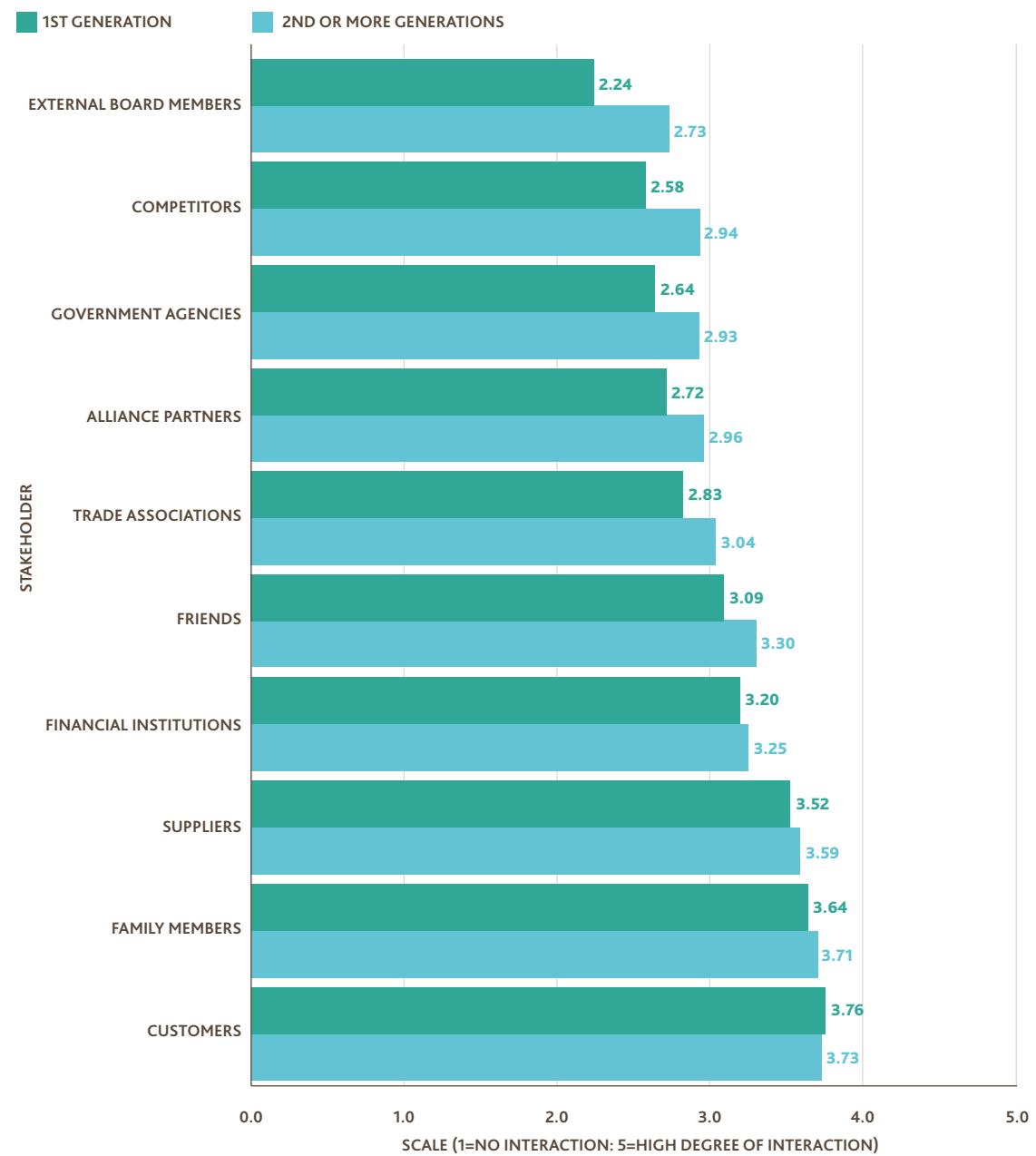


FIGURE 46: NETWORKING INTERACTION ACROSS GENERATIONS

'Learning to lead the family business'

The third building block in the 4L framework moves the focus from learning about business and about our business, to learning about being in charge of the family owned business. This suggests some new questions: what is leadership and what might be special about how future owner managers of family businesses learn their leadership skills? This is less about acquiring knowledge of the business and more about acquiring leadership abilities (Ward & Aronoff, 1994).

Preparing successors to be leaders not only involves them internalising all of the aspects of the business, they must also develop the management skills to influence other people (i.e., communication, motivation, and other managerial abilities), they must come to understand themselves and be conscious of their own strengths and weaknesses (Foster, 1995). Successors need the explicit and implicit management knowledge necessary to identify, solve, predict, and even anticipate problems critical to the family business survival (Leonard & Sensiper, 1998).

Often tacit knowledge, knowledge that is difficult to verbalise or codify to transfer to another person, is core to being able to lead the family business. Family business owners are often unaware of the tacit knowledge they possess or how it can be valuable to others. To effectively transfer tacit knowledge requires a socialisation process, extensive personal contact, regular interaction, and trust. Tacit knowledge can be communicated through a shared understanding between individuals, which includes common schemes and cognitive structures, metaphors and analogies, as well as anecdotes (Grant, 1996).

The success of the knowledge transfer process is impacted by the knowledge codifiability. Here, we distinguished between family and non-family businesses. We observe that family businesses are less likely to codify their knowledge (i.e. documentation and manuals) and hence they might have greater difficulties when transferring knowledge.

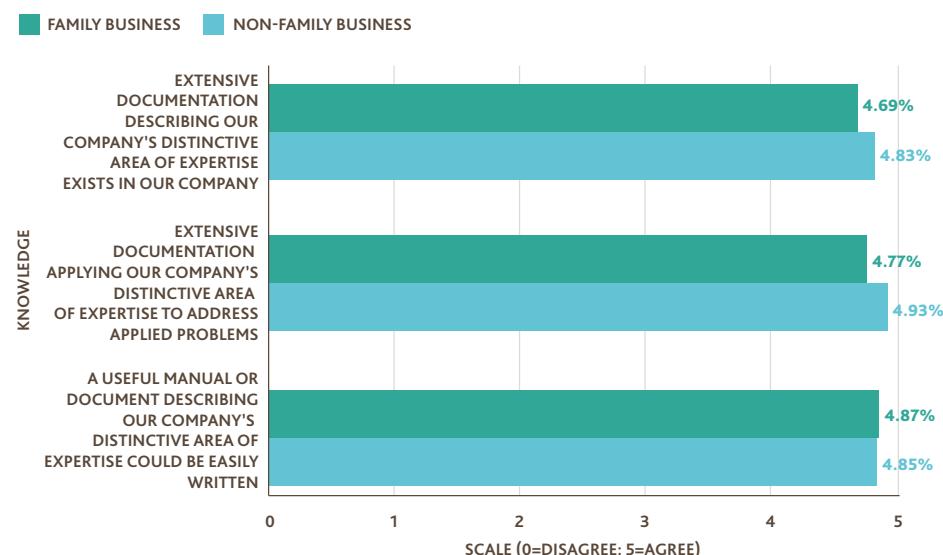


FIGURE 47: DEGREE OF KNOWLEDGE CODIFIABILITY

The ability to transfer knowledge over time, including transfer of best practices, new product development, learning rates, and organisational survival, represents a distinct source of competitive advantage for organisations (Reagans & McEvily, 2003).

"If knowledge is the main resource supporting a competitive advantage, its transferability will determine the period in which its owner can get rents from it". (Spender & Grant, 1996)

Family business successors must internalise all aspects of their particular business and they must acquire the knowledge and 'recipes' about the industry in which the firm operates (Foster, 1995; Tsoukas, 1996). This knowledge transfer is particularly important during the transfer from the first to the second generation, considering that the predecessor is the repository for knowledge of how the main strategic aspects of the business function (Cabrera-Suarez et al., 2001). When we observe the trends, we see that multi-generational firms are more skilled at transferring knowledge, as ease of transfer and codifiability increase across the generations.

"Family business owners are often unaware of the tacit knowledge they possess or how it can be valuable to others. To effectively transfer tacit knowledge requires a socialisation process, extensive personal contact, regular interaction, and trust."

"Our data shows that multi-generational family businesses perceive it slightly easier to transfer knowledge than first generation family businesses."

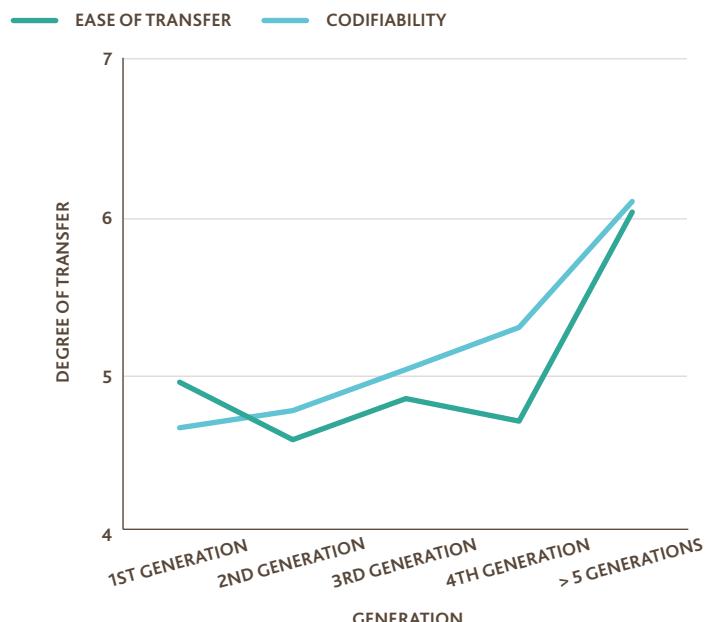


FIGURE 48: KNOWLEDGE TRANSFER ACROSS GENERATIONS

The 'ease of knowledge transfer' is important, since the time and effort required determines the transfer success rate (Reagans & McEvily, 2003). Our data shows that multi-generational family businesses perceive it slightly easier to transfer knowledge than first generation family businesses. One explanation is that it is easier to transfer knowledge for people who share the same background and training (Reagans & McEvily, 2003). The founder generation is often very entrepreneurial and risk-taking, whereas the subsequent generations do not necessarily possess these characteristics. Such differences in the personal characteristics can hinder the ease of knowledge transfer. In multi-generational family businesses, the successors' education and apprenticeship program is often similar to the previous generation and directed towards a future succession process.

"Knowledge codifiability' is also a critical dimension of knowledge transfer."

'Knowledge codifiability' is also a critical dimension of knowledge transfer. It refers to the tacitness of knowledge - the kind of knowledge that can be hard to express or formalise. For family firms, tacit knowledge embedded in the incumbent leader and its transmission to the next generation is a source of competitive advantage. Family firms can develop and transfer knowledge more effectively than non-family firms. This is because there exists a special relationship between the successor and incumbent that goes beyond work and includes personal and family issues (Cabrera-Suarez et al., 2001). Our data shows that for multi-generational family firms it is easier to codify that knowledge. This could be due to the experience those firms already have in codifying and transferring knowledge to the next generation. For first generation family firms, this is a novel process that requires time and effort.

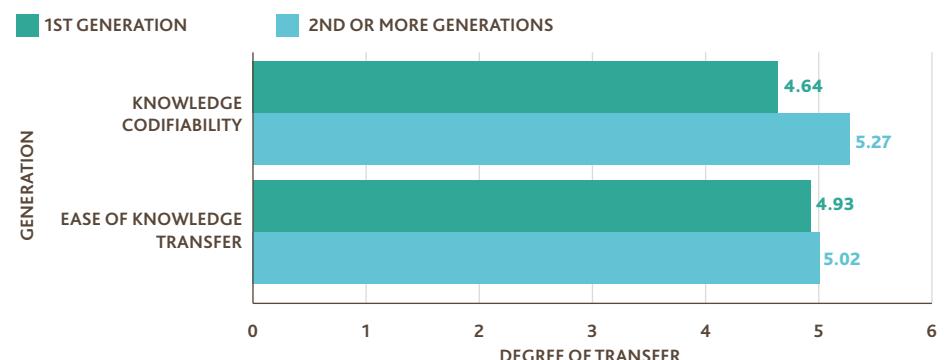


FIGURE 49: EASE OF KNOWLEDGE TRANSFER AND CODIFIABILITY FIRST VS MULTI-GENERATIONAL BUSINESSES

To lead the family business, the successor needs to learn how strategic thinking and operational and financial management skills relate to the family business. Any potential successors within the firm will need to be trained in these areas. When asked about the extent of beneficiary training in business strategy and operations and financial management, most respondents indicated that only a moderate level of training had been reached. This clearly emphasises the need for better training in all aspects of the business to facilitate a successful transfer of wealth.

“... most respondents indicated that only a moderate level of training had been reached.”

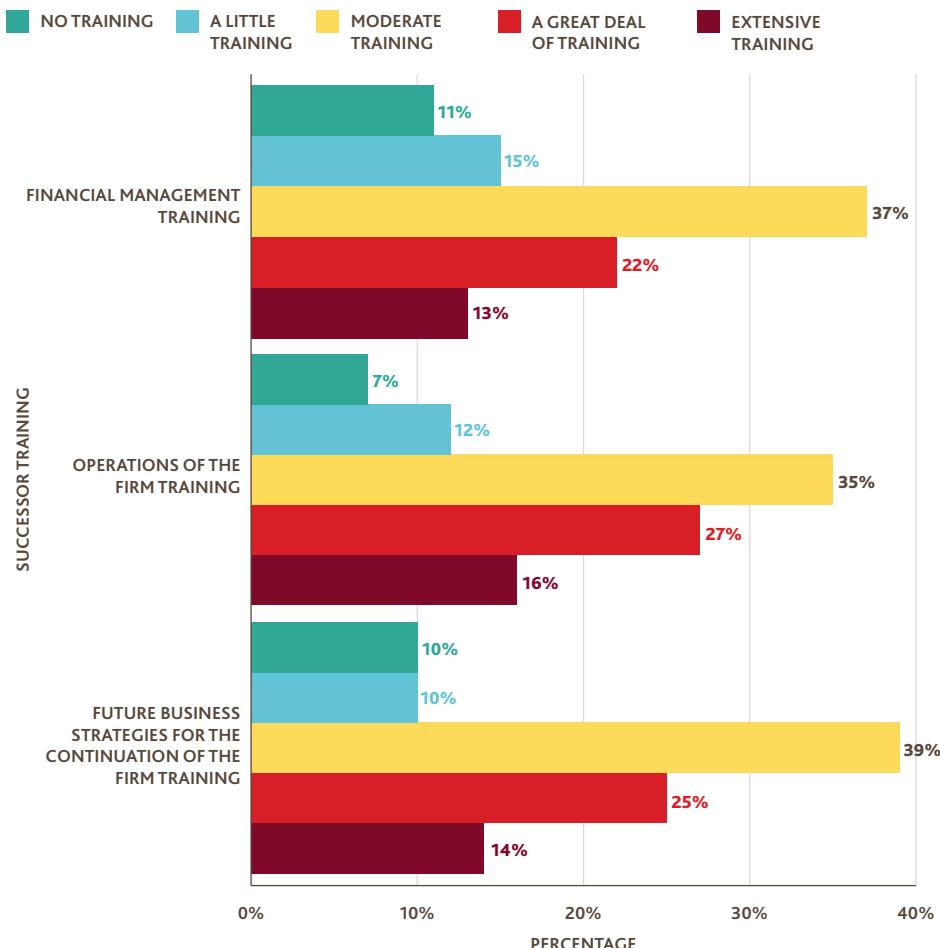


FIGURE 50: TRAINING OF SUCCESSOR IN FIRM SPECIFIC LEADERSHIP SKILLS

The nurturing and development of a potential successor's leadership skills is a key step in the knowledge, and ultimately wealth transfer process for family businesses. Successors have to acquire knowledge, develop capabilities, and achieve credibility through firm specific training.

“Successor's development and preparation for a leadership role ... [is] one of the most important factors among the successful FOBs that survived a succession....45% of all business failures ... were due to incompetent new management.” (Breton-Miller et al., 2004)

Multi-generational firms engage in higher levels of training for potential successors, a key success factor for long run family businesses.

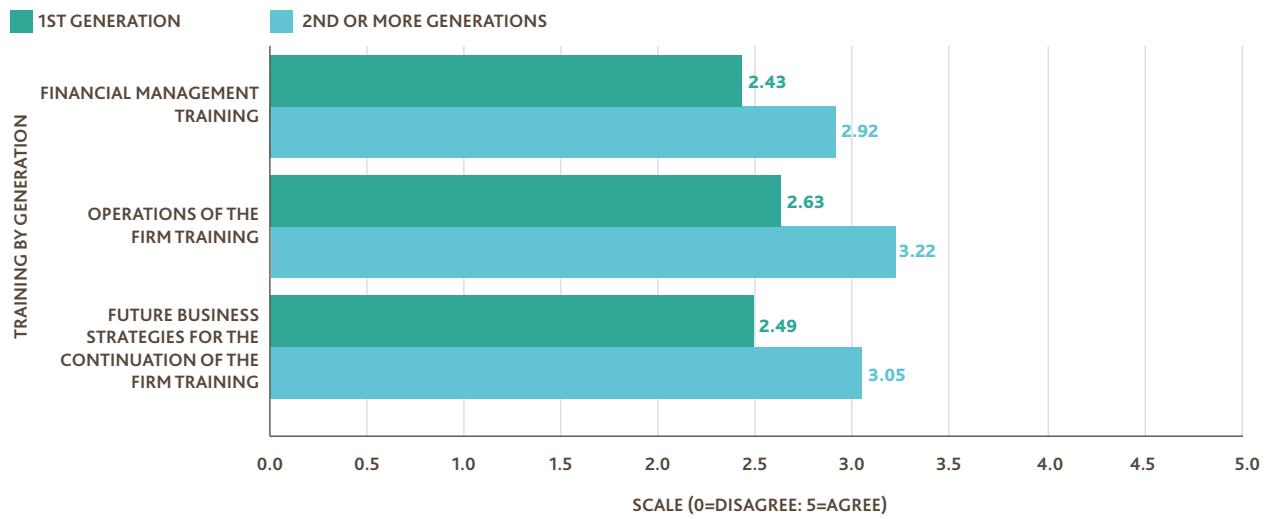


FIGURE 51: AVERAGE SUCCESSOR TRAINING BY GENERATION



'Learning to let go'

Reaching the point where the incumbent, successor, and firm are ready to 'let go' and for the transfer of the family wealth to occur, takes time. We observed that 18% of respondents intend to transfer knowledge within the next three years, while 25% intend to transfer within the next four-five years, and 51% in more than five years.

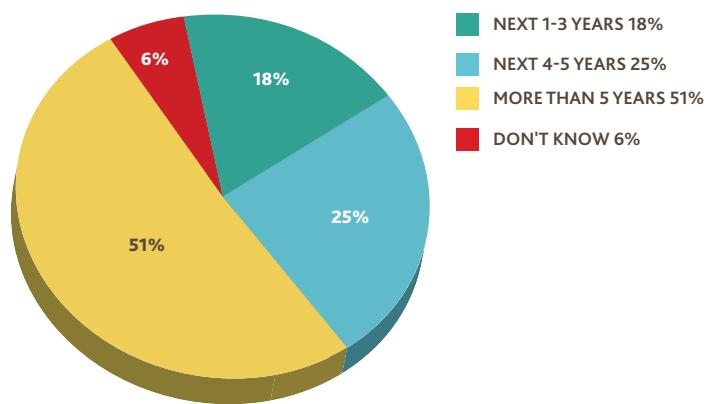
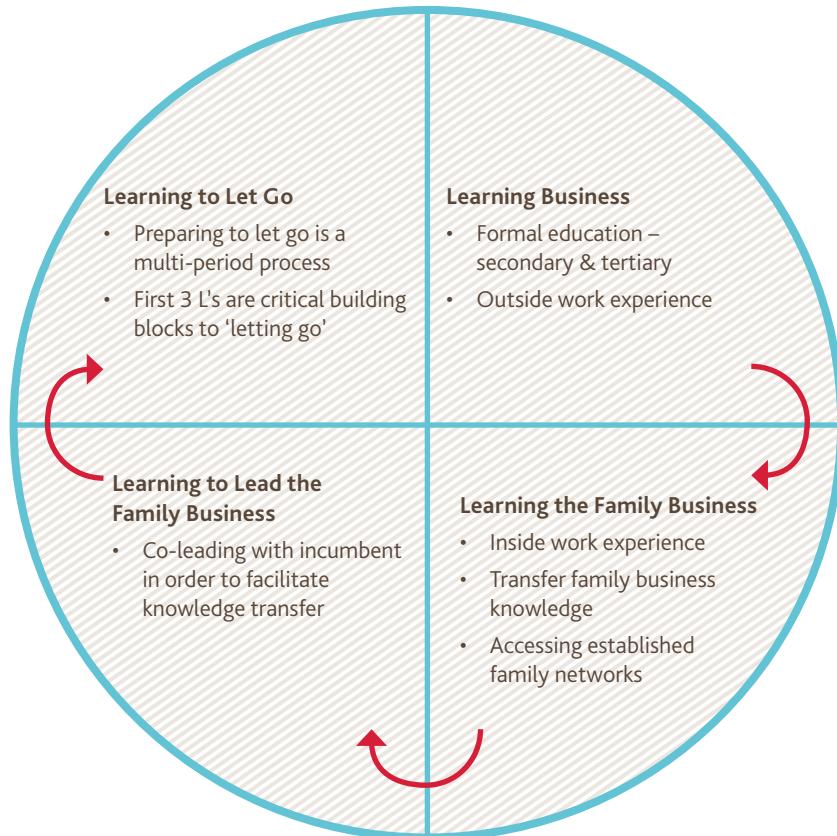


FIGURE 52: TIME HORIZON FOR KNOWLEDGE TRANSFER, IN PERCENTAGE

For most family businesses, there is at least four years to prepare for the knowledge transfer and ultimately the successful wealth transfer. The survey identifies several critical success factors in the knowledge transfer process as part of the 4L's:



"For most family businesses, there is at least four years to prepare for the knowledge transfer and ultimately the successful wealth transfer."

The more successful the knowledge transfer across these dimensions, the better prepared the business leader is 'to let go' of the business and transfer it to the next generation.

Survey demographics

Data collection: To collect the data, an email with a short introduction about the project and a link to the online survey was sent to more than 2500 senior decision-makers in Australian businesses. Data was collected and prepared centrally at the Australian Centre for Family Business (ACFB), Bond University. A total of 320 completed surveys were analysed.

Respondent location

The majority of respondent businesses are located in New South Wales (36%), Victoria (22%), and Queensland (21%). The remaining share is located in South Australia (9%), Western Australia (7%), Tasmania (4%), and Canberra (1%).

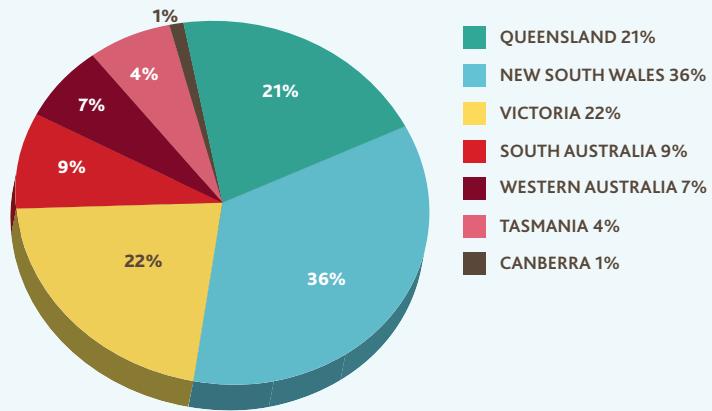


FIGURE 53: LOCATION OF SAMPLED FIRMS, IN PERCENTAGE

Respondent industries

Respondent businesses belong to a wide variety of different industries, and were grouped according to the ANZSIC classification. The three major industries in the sample are manufacturing (17%), personal and other services (17%), and construction (12%).

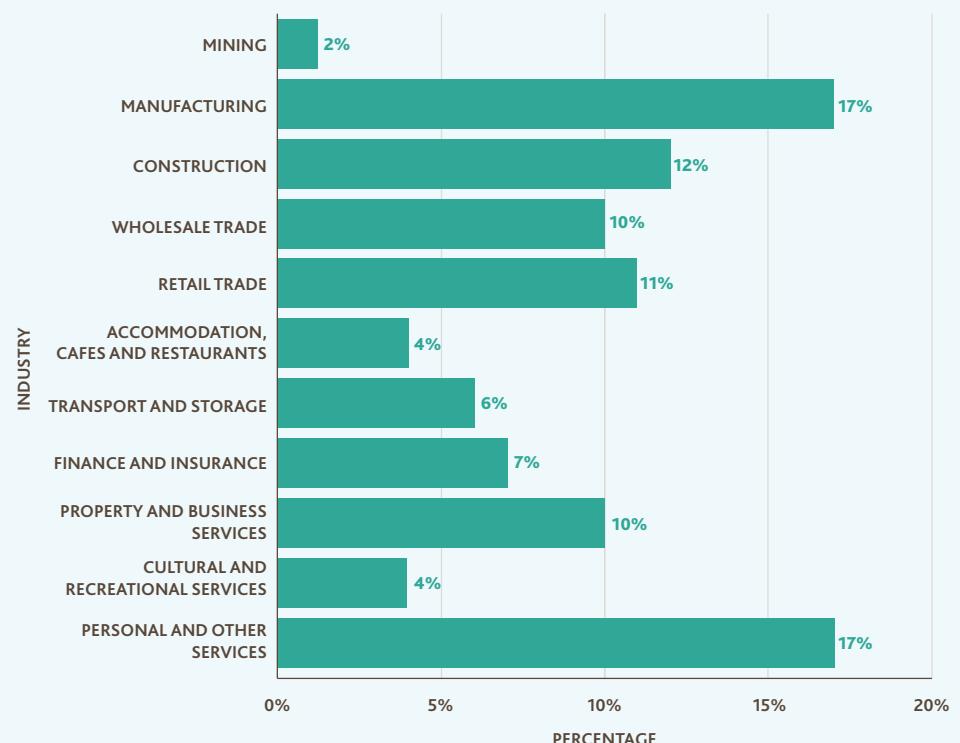


FIGURE 54: INDUSTRY ASSOCIATION OF SAMPLED FIRMS, IN PERCENTAGE

Firm size

Respondent businesses ranged in size, measured by both number of employees and sales revenue. The first size measure, number of employees, indicated that 14% were microbusinesses with one-five employees and 10% microbusinesses with six-ten employees. Further, 50% of the businesses employ more than ten and up to 100 employees and 18% employ 101-500 employees. Another 5% employ 501-1000 people and 3% employ more than 1000 people.

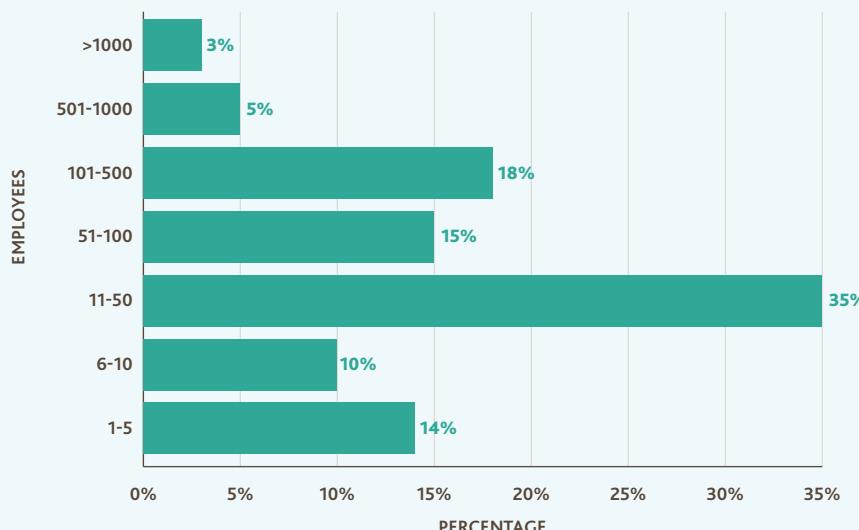


FIGURE 55: TOTAL NUMBER OF EMPLOYEES OF SAMPLED FIRMS, IN PERCENTAGE

In terms of total sales as a size measure, 5% of respondent businesses generate less than A\$50,000. A further 27% have sales revenues between A\$50,000 and A\$500,000, and 7% between A\$500,000 and 1 million. The largest share (37%) of businesses generates sales of between A\$1 million and A\$5 million. Moreover, 18% have sales revenue of A\$5 million to A\$50 million, and 7% have sales of more than A\$50 million.

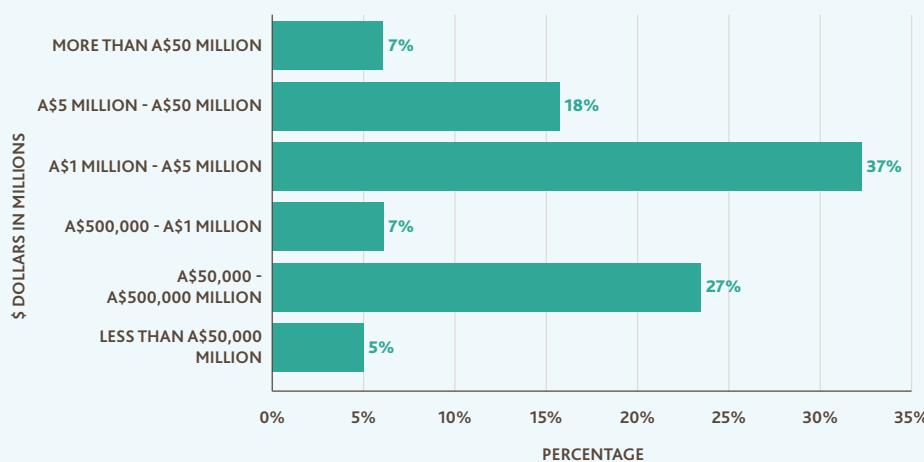


FIGURE 56: SALES REVENUE OF SAMPLED FIRMS, IN PERCENTAGE

Respondent demographics

The largest share of respondents have held their current position in the company for three and up to five years. The majority hold a tertiary qualification, 41% hold an undergraduate university degree and 20% are in a possession of a postgraduate university degree. The respondent ages were equally spread across the groups of 25 to 39, 40 to 54, and over 54 years of age. Importantly, 54% are major shareholders of the business, a further 21% are minor shareholders and 25% do not possess any share in the business. Furthermore, 73% are male and the remaining 27% are female.

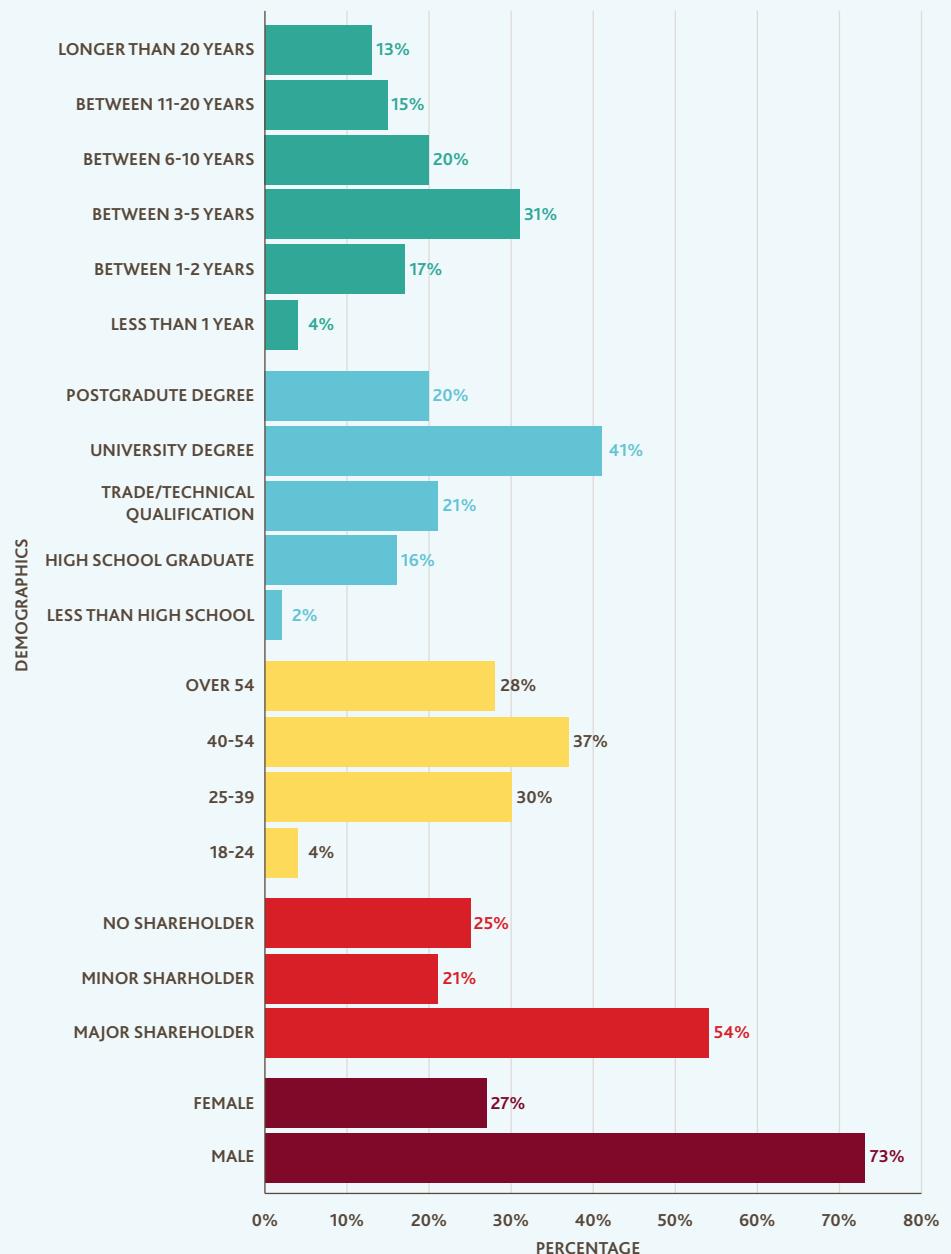


FIGURE 57: RESPONDENT DEMOGRAPHICS, IN PERCENTAGE

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About BDO

As the fifth largest accounting and advisory network, BDO operates in 1,204 offices across 138 countries employing 54,933 people globally.

In Australia, BDO draws expertise from over 170 partners and over 1,370 people from offices in Adelaide, Brisbane, Cairns, Darwin, Hobart, Melbourne, Perth and Sydney.

With a constantly evolving tax system in Australia, effectively managing tax affairs is an increasingly challenging but essential part of your business or personal financial planning.

In this fast-paced tax environment we can help save you or your business money and time, and reduce your risk exposure. BDO is renowned for its expertise and in depth understanding of the issues.

Our strategic tax planning expertise includes corporate tax, structuring of acquisitions and disposals, stamp duty, GST and capital gains tax as well as a range of other specialist advice.

We also provide specialist taxation advice for private clients, giving you the detailed insight you need to make effective taxation decisions. From income tax, to indirect taxes and international tax advice, our clients are guaranteed a discreet and personal service.

Fifth

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54,933

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About BDO's Family Business services

With over 25 years' experience and an in-depth understanding of the challenges facing stakeholders within a family business, BDO is a leader in family business advising. We work closely with our clients to help them balance the needs of the family with those of the business.

Family businesses of all sizes and types dominate the private sector in Australia. Some of the most successful and professional companies — many of them household names — are family-owned and run.

Developed from the vision and hard work of the founder, these businesses take on their unique character as other members of the family enter the business. At best, such an environment can be inspiring and motivating. At worst, it can result in routine business decisions becoming clouded by emotional issues.

BDO approach

Our role as trusted business advisers is to help families reach agreements in creating a workable framework for the future of their business. Building a consensus when 'family' and 'business' issues are involved is not an easy process — it needs to be handled sensitively and methodically, ensuring that the relevant family members are included in the process and are all working towards the same goals.

The BDO methodology, which has been developed and tested under the most challenging family business circumstances, has proved to be successful, flexible and able to be individually tailored for clients. There are five stages to the process:

- 1.** An initial family gathering, covering the principles of owning a family business.
- 2.** Individual meetings with family members and key stakeholders, using a specially developed questionnaire format.
- 3.** Identification and prioritisation of key issues for the family and the business, which are used to develop a draft family charter.
- 4.** A family retreat over two days, at which family members reach a consensus on the issues identified, complete a family charter and establish a family council.
- 5.** Post-retreat follow up; the completed family charter is usually issued at the next family council meeting.

How can we help you?

Our family business advisers have been widely recognised for their extensive experience in working with a broad range of reputable family businesses to deliver solutions and ideas that are tailored to the needs of our clients. We place importance upon a personal, partner-led approach that is based on fostering close working relationships with our clients. Our advisers work with family businesses to first understand the needs of the business and family, and then develop strategies for handling the sensitivities that inevitably exist or arise.

Our team of experts brings a wealth of knowledge and expertise from a wide range of industry sectors and can draw from an extensive BDO network of resources, including local educational activities, networking events, and expert advice on family business issues. This ensures that we keep you up to date with the latest industry challenges and trends.

Our team engages in continual learning through:

- Cutting-edge research, which includes our involvement with the Australian Centre for Family Business, an internationally recognised leader in family business research
- Completion of BDO's international accreditation program for family business advisers
- Participation in Family Business Australia's accreditation program
- Participation in Family Firm Institutes International certificate program.

BDO has produced a range of tools and publications that can assist family business. This report and other useful material are available at www.bdo.com.au or via the BDO Australia iPad App.

Survey Contributors



Bond University

Bond University is Australia's first private, non-for-profit University, offering a personalised academic environment that enables graduates to exceed the outer limits of their potential.

Located on Australia's Gold Coast, Bond University offers degrees through faculties:

- Faculty of Business
- Faculty of Health Sciences & Medicine
- Faculty of Humanities & Social Sciences
- Faculty of Law
- Faculty of Sustainable Development & Architecture
- English Language Institute
- Dispute Resolution
- Bond College.

Bond's personalised approach to the education process combined with its uncompromising focus on industry relevance, world class facilities and international links sets Bond University apart.

Research has become a key focus for the University. It is prominent now in every facet of Bond University's policies and we are committed to contributing to the body of knowledge we teach. As a small university, with an entire student population ten times smaller than the average public university, our research capabilities are comparable to others adjusted for size.

Our research vision

It is important for Bond to remain small, but focused – with an emphasis on quality. Over the next five years we aim to build on areas of existing research strength and look to expand into adjacent areas.

Strengthening our research base will reinforce Bond's role in the local community by supporting research into local issues and developing innovative solutions.

The Research Strategic Plan 2013-2017 is currently under development.



ACFB

The Australian Centre for Family Business (ACFB) is a research centre within the Faculty of Business at Bond University. It was founded in 1994 by Professor Ken Moores with assistance and input from a coterie of like-minded leaders from Australia's family business community. Professor Michael Harvey is the acting Director, ACFB.

The mission of the ACFB is to enhance the prospects for profitable continuity of family businesses for the benefit of family members, shareholders and non-family employees and to become a world class centre.

We are well on the way to fulfilling our mission. Since the launch of the ACFB in 1994 we have steadily built an international reputation for our research and pedagogy. We acknowledge, however, that we have only scratched the surface of building knowledge and understanding of family business and welcome you to engage with us in some capacity to continue to achieve our mission to contribute to the economic and social development of Australia by enhancing the prospects for profitable continuity of Australian family businesses.

Building knowledge and understanding of family business is reliant on building close and lasting relationships with family businesses. This has been achieved through the ongoing support of Family Business Australia and collaborations with leading professional firms such as BDO. In addition, we have been able to glean rich insights by working with many of Australia's leading family businesses and from the Bond student community.

ACFB scholars have built an international reputation for their applied approach to family business research and for their innovative evidence-based family executive education programs. As one of Australia's leading educational and research centres, we bring together world-renowned academics and leading industry experts to deliver cutting-edge content for the executive market.

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