Chapter 8

The family business sector's access to finance and its response to the global financial crisis

8.1 The sixth and seventh articles of the terms of reference direct the committee's attention to the capacity of family businesses to access to finance and insurance, and their resilience in response to the global financial crisis (the GFC). This chapter addresses these issues.

A family business or a small and medium enterprise?

8.2 Chapters 2, 3 and 4 of this report noted the lack of reliable official data on most aspects of family businesses in Australia. This is also the case in terms of family enterprises' access to finance and insurance, and the sector's resilience in the wake of the GFC.

8.3 The committee's evidence about the family business sector's access to finance and resilience following the GFC was predominantly focused on small and medium family enterprises.[1] Data on large family businesses was limited.

8.4 Evidence received from Authorised Deposit-taking Institutions (ADIs) and financial regulators particularly illustrated the overlap between SME data and family business statistics. The Reserve Bank of Australia (the RBA) advised that it 'would not profess to have any specialist knowledge about family businesses'. Rather, the RBA 'focuses on small and medium enterprises' reflecting its 'area of particular interest, which is monetary policy and how decisions on monetary policy are flowing through to small, medium and large businesses'.[2]

8.5 In response to a question on the importance of distinguishing between family and non-family enterprises, the RBA advised that such data 'is not irrelevant'. However, at this time the RBA does not perceive any clear benefits to isolating family business data:

> It is not irrelevant. It is about the marginal benefit of going down that route versus the cost. For us, we may not decide that the benefits would be enough, because we think we get enough information on small businesses. But if you are trying to develop policy and family businesses you will have a different view on that. In an ideal world, the statistical form that people fill in would be bigger and there would be a field to do with family

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1 See, for example, Commonwealth Bank of Australia, *Submission 24*, pp 1–4; Deloitte Private, *Submission 16*, pp 26–27; Reserve Bank of Australia, *Submission 17*, p. 1.

2 Mr Christopher Aylmer, Head, Domestic Markets Department, Reserve Bank of Australia, *Committee Hansard*, 15 November 2012, p. 3.

> businesses. That would let you slice or dice the information in the way that you wanted to instead of adopting a single standard everyone.[3]

8.6 Similarly, the Commonwealth Bank of Australia (the CBA) advised that it 'does not categorise information from our customers on the basis of "family" as opposed to "small" business'.[4] The CBA also questioned the practicality of isolating family business data from non-family businesses, advising that 'it is difficult to distinguish a "family business" from a "small business" from a policy perspective'.[5]

8.7 The RBA acknowledged the limitations in the statistics presented. As Mr Christopher Alymer of the Domestic Markets Department advised:

> I would like to...draw the committee's attention to the fact that a lot of the observations we have made in the supporting documentation have actually been focused on small and medium-sized enterprises as opposed to family businesses. To a large degree that reflects the availability of statistics, if the truth be known.[6]

8.8 The lack of a clear demarcation between SME data and data focused on family business was also evident in representations of family business advisers and others concerned with the family business sector. For example, BusinessSA, Bond University, and the Institute of Certified Bookkeepers, oscillated between references to the family business sector and references to SMEs.[7] Accordingly, data was extrapolated from SME statistics and conclusions were based on inference. The submission from Deloitte Private is illustrative of this approach:

> Commercial banks have significantly reduced their lending since the GFC, particularly to small and medium businesses in which family businesses predominate…many family businesses have difficulty accessing bank funding. According to the results of the above-mentioned CPA survey on small businesses, 32 per cent of small businesses seeking additional financing in 2011 found it difficult or very difficult. [8]

8.9 Similarly, the Chamber of Commerce and Industry Queensland (CCIQ) linked the family business sector to the SME sector. It advised that 'many small businesses reported adverse impacts as ongoing following the GFC, and family businesses as a subgroup of SMEs was not immune'.[9]

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3 Mr Aylmer, Reserve Bank of Australia, *Committee Hansard*, 15 November 2012, p. 1.

4 Commonwealth Bank of Australia, *Submission 24*, p. 2.

5 Commonwealth Bank of Australia, *Submission 24*, p. 1.

6 Mr Aylmer, Reserve Bank of Australia, *Committee Hansard*, 15 November 2012, p. 1.

7 BusinessSA, *Submission* 23, p. 2; Bond University, *Submission 3*, p. 9; Institute of Certified Bookkeepers, *Submission 36*, p. 4.

8 Deloitte Private, *Submission 16*, pp 26–27.

9 CCIQ, *Submission 19*, p. 2.

Submitters' acknowledgement of data limitations

8.10 The lack of targeted data was also the subject of comment by family business advisers and academic researchers. It was strongly submitted that there would be economic benefits to obtaining data specific to family businesses. For example, in their joint submission, Dr Chris Graves, Professor Mary Barrett and Dr Jill Thomas identified three potential benefits of longitudinal data about the financing preferences of family businesses. First, the data would increase understanding of the impact of business culture on the sector's economic performance. Second, the information would lead to more targeted professional advice and ultimately 'allow external advisers to help family firms professionalise their management and governance structures'. Third, the data would broaden the scope of finance available to the family business sector, as a more professional sector would more easily attract private equity providers.[10]

Access for small and medium business to finance

8.11 The committee's analysis of the family business sector follows its earlier inquiry into access to finance for SMEs. Reporting in April 2011, the committee considered the types of finance that are available to SMEs, the degree of competition in SME lending, and the impact of prudential regulation and the GFC on the availability of finance.[11]

8.12 The committee's inquiry found that while Australia weathered the GFC, the crisis reduced the number of providers and increased the cost of finance. SMEs continued to have access to finance, albeit on less favourable terms.[12] Notably, SMEs appeared to fare better than large businesses. Lending to large businesses declined dramatically while lending to SMEs declined more modestly and recovered more swiftly.

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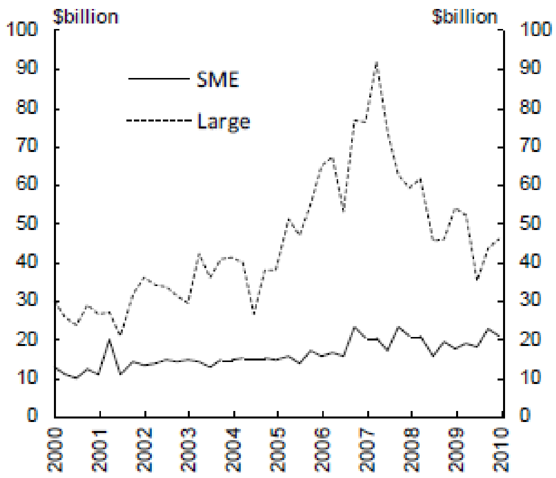
10 Dr Chris Graves, Family Business and Education and Research Group, University of Adelaide, Professor Mary Barrett, School of Management and Marketing, University of Wollongong, Dr Jill Thomas, Family Business Education and Research group, University of Adelaide, *Submission 14*, p. 5.

11 Parliamentary Joint Committee on Corporations and Financial Services, *Access for small and medium business to finance*, 'Terms of Reference', April 2011, p. vii.

12 Parliamentary Joint Committee on Corporations and Financial Services, *Access for small and medium business to finance*, April 2011, pp 15–16.

Figure 8.1: Bank lending to business[13]



Source: RBA D7 – Bank lending to business

8.13 In evidence provided to this inquiry, the RBA confirmed that growth in lending to small business has accelerated since the height of the GFC.[14]

Committee view: a word of caution

8.14 The utility of evidence from ADIs and the RBA is limited. This evidence was largely extrapolated from SME data and is based on inference and supposition. The committee further notes that it is not a broad sample of the banking and finance sector. The committee invited 18 ADIs, and other lending and insurance institutions, to contribute to the inquiry. Despite this, only two lending institutions—the CBA and the Commercial Asset Finance Brokers Association of Australia—participated in the inquiry process. Notably, no representations were made by members of the mutual banking sector. No representatives of the insurance sector participated in the inquiry.

8.15 Noting these limitations, the committee draws general conclusions about the sector's access to finance and insurance, and resilience in response to the GFC. Where possible, it compares family and non-family enterprises. In doing so, the committee seeks to identify any overlap in circumstances faced by family businesses and the SME or large business sector.

Access to finance

8.16 A theme that emerged from the committee's 2011 inquiry into access to finance for SMEs was the significant link between business lending and business

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13 Parliamentary Joint Committee on Corporations and Financial Services, *Access for small and medium business to finance*, April 2011, p. 14; Treasury, *Submission 16—Access for small and medium business to finance*, 2011, p. 5.

14 Reserve Bank of Australia, *Submission 17*, p. 1.

growth and profitability. As the committee was advised at the time of that inquiry, SMEs 'need financial support to grow and thrive'.[15] Evidence submitted as part of the committee's current inquiry indicated that the family business sector places the same emphasis on the importance of access to financial resources.

8.17 PricewaterhouseCoopers told the committee that in the international context, securing access to finance is a critical issue common to family businesses regardless of geographical location. The PricewaterhouseCoopers' 2012 survey of approximately 2000 family businesses from Africa, the Asia-Pacific, the Middle East, Europe and Canada found that 'family businesses often face difficulties accessing significant levels of new capital to fund expansion'.[16] For Australian family enterprises, accessing finance is reportedly one of the critical issues demanding the businesses' attention.[17] The link between access to finance and the health of the family business sector was family business owner, Mr Robert Pennicott: 'without bank assistance we would not have been able to expand in the way we have, for sure'.[18]

8.18 The New South Wales Business Chamber told the committee that the health of the family business sector is linked to the health of the economy and the community. It argued that any difficulties accessing finance have ramifications that extend beyond individual family businesses:

> [A]t the end of the day what we are missing out on is opportunities. This is the 30 per cent who had to forgo growth and expansion opportunities. There is a cost to jobs and there is the cost to local communities and the broader economy as a result.[19]

The experience of family enterprises compared with non-family enterprises

8.19 Views differed on whether the difficulties encountered by family business are greater than those experienced by non-family enterprises. On the one hand, the committee was advised that the difficulties encountered by family businesses do not measurably differ from non-family enterprises. Conversely, the committee was told that family businesses encounter challenges unique to the family business sector.

8.20 In support of the proposition that there is little to distinguish the financial experience of non-family enterprises from family businesses, family business owner,

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15 NAB, *Submission 19—Access for small and medium business to finance*, 2011, p. 1.

16 PricewaterhouseCoopers, *Family firm: A resilient model for the 21st century*, October 2012, p 11.

17 Professor Kosmas Smyrnios, *The MGI Australian Family and Private Business Survey*, July 2010, p. 15.

18 Mr Robert Pennicott, Managing Director, Pennicott Wilderness Journeys, *Committee Hansard*, 21 January 2013, p. 28.

19 Mr Paul Orton, Director, Policy and Advocacy, New South Wales Business Chamber, *Committee Hansard*, 15 November 2012, p. 20.

Mr Andy Kennard, reported that there is '[n]othing different due to being a family business'.[20] The Commercial Asset Finance Brokers Association of Australia reported that its members experienced similar challenges regardless of whether the entity is a family or a non-family business.[21] The Agribusiness Council of Australia observed that access to finance, and the cost of finance, 'is not significantly affected by the status of the business being a family business'. Further, the Agribusiness Council of Australia maintained that businesses status as a family enterprise 'is of little or no consequence to finance providers'.[22]

8.21 Similarly, while acknowledging slight variances, the New South Wales Business Chamber reported that barriers to finance do not significantly differ between family and nonfamily enterprises. Commenting on the results of its most recent quarterly survey of business conditions among its membership, the Chamber advised that family businesses were more likely to have had a formal loan application formally rejected. It found that in terms of loan approvals, family businesses were:

> …somewhat more likely to have been rejected: 26 per cent versus 19 per cent of businesses of their type that actually applied. Overall, though, the indication is that family businesses had about the same level of problems accessing finance as other businesses.[23]

8.22 In contrast, several submitters characterised the family business sector as unique, particularly in the area of business finance. The Australian family businesses that participated in PricewaterhouseCoopers' 2012 survey submitted that the barriers to accessing funding are greater for family businesses than for their non-family counterparts. The apparent, but unspecified, additional challenges are reportedly among the 'downsides' of operating a family enterprise.[24] Bond University also commented on the challenges that may be unique to the family business sector, noting that the desire to retain control within the family can limit available financing options and, accordingly, exacerbate the 'SME finance gap' for family businesses.[25]

8.23 Submitters also commented on the effect of governance structures on the sector's capacity to access finance. Several family business owners advised that the more sophisticated and experienced a family business is, the easier it is to acquire finance. Councillor Steven Kons, Mayor of the Burnie City Council, speculated that the more informal, community-based management style of family businesses can hinder businesses from accessing finance:

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20 Mr Andy Kennard, *Submission 5*, p. 2.

21 Commercial Asset Finance Brokers Association of Australia, *Supplementary Submission*, p. 1.

22 Agribusiness Council of Australia, *Submission 37*, p. 8.

23 Mr Tim Hicks, Policy Adviser, Business, Regulation and Economics, New South Wales Business Chamber, *Committee Hansard*, 15 November 2012, p. 17.

24 PricewaterhouseCoopers, *Submission 11*, Attachment A, p. 17.

25 Bond University, *Submission 3*, pp 8–9.

> It is probably easier for non-family businesses. The level of sophistication and capacity to prepare documentation is much easier for non-family businesses, because when you are on top of it, and you are having a look at your daily cash flows and those sorts of things, you tend to gloss over the detail that other entities—whether it is banks or financiers, you know it inside out; if you are a small company that reports to someone else you have those at hand and you are distanced from it. I know exactly how much money I have in the bank, how much is coming in and all those sorts of things. So in relation to the expectations of banks and other agencies that may be interested in my business: I know them, so I gloss over them when it is necessary to provide them. That is probably an impediment because of the hands-on way we run our businesses.[26]

8.24 It was implied that family dynamics and future planning are relevant to the sector's capacity to access finance. Mr Albert Beard, Chairman and Managing Director, A. H. Beard Manufacturing, argued that the education and experience of family members is a criteria considered when seeking finance:

> Because our business relies very much on cash flow lending, the quality of people at the business is very high on the agenda, without involving bricks and mortar. So yes the qualifications are very important to what I know about the ANZ bank. They are probably already ticking those boxes themselves.[27]

8.25 Similarly, Mr Mark Cleary, a business adviser to the Gosford-based family firm, Sharpe Bros, spoke of the relevance of governance structures and succession plans to family businesses' capacity to access finance.[28]

Funding sources

8.26 It was further submitted that the funding preferences of family businesses distinguish the sector from non-family enterprises. SMEs can access a combination of debt and equity finance, which can include internal funding, owner equity, venture capital, secured and unsecured intermediated credit, and bank bills. Overall, however, SMEs primarily rely on debt funding from ADIs followed by internal resources.[29]

8.27 In contrast, anecdotal evidence before the committee indicated that the funding priorities of family businesses differ from that of the SME sector more

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26 Councillor Steven Kons, Mayor, Burnie City Council, *Committee Hansard*, 21 January 2013, p. 3.

27 Mr Albert Beard, Chairman and Managing Director, A. H. Beard Manufacturing, *Committee Hansard*, 15 November 2012, p. 52.

28 Mr Mark Cleary, Business Adviser, Sharpe Bros, *Committee Hansard*, 15 November 2012, pp 52–53.

29 Parliamentary Joint Committee on Corporations and Financial Services, *Access for small and medium business to finance*, April 2011, pp 6–7.

broadly. It was apparent that family businesses access a mixture of debt finance, equity and reinvestment of business profits.[30] From the available anecdotal evidence, a funding hierarchy emerges with own-source funding by way of family loans or reinvestment of profits being the preferred source of finance.[31] As KPMG advised, bank debt is incurred only after own-source funding options have been exhausted.[32] As explored below, private equity was reportedly the least favoured finance option.[33]

8.28 This hierarchy, it was suggested, reflects the conservative mindset of family businesses.[34] Chapter 4 identified the conservative, 'patient capital' approach to business finance as a key point of difference between family businesses from non-family enterprises. As Institute of Chartered Accountants Australia (ICA) reported:

> [r]esearch and anecdotal information indicates that family businesses tend to be more risk averse and desire to retain greater control over their business affairs than non–family businesses. This is reflected in their appetites for credit, with greater use of bank finance and lower use of external sources of equity finance.[35]

8.29 Bond University agreed with this view, advising that the reliance on own source funding is particularly pronounced for smaller family businesses:

> [S]mall family businesses in particular tend to rely heavily on family loans, rather than loans to outsiders as a source of finance. Consistent with their noneconomic objectives, these preferences protect the family's influence over the firm's operations…family firms will utilise more internal rather than external sources of finance.[36]

8.30 On the basis of available research, Bond University concluded that while SMEs can rely on own-source finance, there is a greater reliance on internal equity among family businesses.[37]

Concerns with access to ADI debt finance

8.31 Family businesses and their representatives reported four concerns with debt financing from ADIs. The first of these is the lack of competition between lenders.

30 See, for example, KPMG, *Submission 21*, p. 19; Kosmas Smyrnios, and Lucio Dana, *MGI New Zealand Family and Private Business Survey 2007*, 2007, p. 16.

31 Professor Kenneth Moores, Executive Chairman, Moores Family Enterprise, *Committee Hansard*, 16 November 2012, p. 24.

32 KPMG, *Submission 21*, p. 19.

33 See, for example, Institute of Chartered Accountants Australia, *Submission 25*, p. 5.

34 Institute of Chartered Accountants Australia, *Submission 25*, p. 5.

35 Institute of Chartered Accountants Australia, *Submission 25*, p. 5.

36 Bond University, *Submission 3*, p. 10.

37 Bond University, *Submission 3*, p. 11.

The committee was advised that the majority of family businesses borrow from 'the Big 4' as opposed to smaller lenders or the mutual sector.[38] Pitcher Partners argued that there is a lack of banking competition within the Australian market, which presents challenges for family businesses:

> With access to debt funding, there is a current lack of competition in the banking sector that acts as an impediment to family businesses. The loss of St George into Westpac and Bank West into CBA during the immediate aftermath of the GFC removed two emerging and competitive financial institutions from the market place. This void is slowly being filled again but it will take many years for rising institutions to reach sufficient critical mass to be truly competitive and have the breadth of finance options available.[39]

8.32 Pitcher Partners further submitted that the absence of competition undermines family businesses' capacity to negotiate favourable finance terms:

> Examples have also been noted of what could be described as a brinkmanship approach by financiers to re–negotiation of facilities at a time when alternative options are few. The lack of competition therefore has a real cost to family business and influences its competitiveness.[40]

8.33 MGI Australasia also argued that there is currently a lack of choice and product diversity in the Australian ADI market:

> The Australian banking market is dominated by the Big 4…Whilst the existence of four players should in theory lead to substantial competition the reality is that it does not and the offerings of these 4 banks are constantly very similar and rarely substantially different…The other smaller banks have been regularly acquired by the Big 4 over the last decade so that the remaining smaller banks are ill placed to provide meaningful competition across the full range of products.[41]

8.34 MGI Australasia also submitted that the absence of meaningful competition increases operating costs for family businesses:

> By world standards Australian banks are extremely profitable. Large public listed corporations and multi–national companies are the only enterprises in the Australian economy that can extract competitive deals in our banking market. The result of this lack of real competition is that family businesses are incurring substantially higher funding costs than their competitors in other world markets.[42]

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38 MGI Australasia, *Submission 9*, p. 8.

39 Pitcher Partners, *Submission 28*, p. 12.

40 Pitcher Partners, *Submission 28*, p. 13.

41 MGI Australasia, *Submission 9*, p. 8.

42 MGI Australasia, *Submission 9*, p. 8.

8.35 Second, it was submitted that the terms and conditions of ADI finance are inappropriate for family businesses. Several submitters noted that family businesses may be required to blur the boundaries between personal and business assets in order to secure business finance. Commenting on her experience as a family business owner, Mrs Janice Taylor of Taylor Bros. Holdings Pty Ltd, informed the committee that:

> [t]o enable finance to be put in place it is usually an expectation of the financial provider that the business shareholders/directors/family members will provide asset backing whether it be business premises, private property, private share holdings, or any other privately held assets.[43]

8.36 Mr Michael Claydon, the Managing Director of the Perth-based firm National Corporate Training Pty Ltd, recounted a similar experience:

> We are in the growing phase and we find it extremely difficult to get finance from banks. You basically need to have it to get it—that is the thinking behind banks. I do not know whether there is any particular issue with family business versus a standard business, but certainly the basic rule is that if you do not have it you cannot get it. The only way to get finance is to put your home up as part of the collateral.[44]

8.37 Family business advisers also commented on this practice. Pitcher Partners noted that accessing even a 'modest amount' of capital will 'frequently…involve pledging private assets such as a family home as security'.[45] A 2009 KPMG survey of family businesses observed that finance options can merge a family's private life with the family's business ventures. It found that 41 per cent of directors in a family business had given personal guarantees to obtain debt funding. In contrast, only approximately 25 per cent of non-family businesses surveyed reported giving personal undertakings in order to secure business finance.[46]

8.38 Family business advisers told the committee that the security requirements indicate that the ADI sector that does not appropriately support family businesses. The ICA submitted that it is the value of security, rather than the success or the viability of the business, that determines a family business' capacity to access capital.[47] Deloitte Private argued that the requirement to provide security limits the growth of the family business and hinders family businesses from reaching their economic potential:

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43 Taylor Bros, *Submission 38*, p. 3.

44 Mr Michael Claydon, Managing Director, National Corporate Training Pty Ltd, *Committee Hansard*, 2 February 2012, p. 21.

45 Pitcher Partners, *Submission 28*, p. 12.

46 KPMG and Family Business Australia, *KPMG and Family Business Australia Survey of Family Businesses 2009*, p. 17, http://peak.fambiz.org.au/education/resources/australian-family-business-surveys-statistics (accessed 23 October 2012).

47 Institute of Chartered Accountants Australia, *Submission 25*, p. 5.

> As shown in the CPA survey, the commonly cited difficulty in accessing bank funding related to the willingness of the financiers to provide the funding. Other factors include the reluctance of financiers to provide cashflow based loans to small and medium sized enterprises, which includes many family businesses. Consequently, a family business' ability to fund its growth potential is often constrained by the security available to be offered. Many family businesses are reluctant to provide security and therefore face a funding squeeze when seeking to financing their growth potential.[48]

8.39 Ultimately, it was questioned whether ADIs are willing to engage with the family business sector. As the Institute of Certified Bookkeepers stated:

> It also appears in the current banking environment family business is not supported by the lenders. Without family providing security (the house, or other property, personal guarantee), a family business cannot generate the finance. It would appear that the lenders do not in fact a wish to lend to a family business but will lend to the family if there is sufficient security and other income to service the debt.[49]

8.40 The accountancy firm, FINH, argued that the reticence of the ADI sector to engage with family businesses requires family businesses to merge private and business assets, thereby increasing their reliance on family funds and internal revenue.[50]

8.41 Third, it was argued that the risk ratings attached to family business finance applications are inappropriate. Deloitte Private noted that in response to the GFC, the level of funding had decreased while the cost of funding has increased.[51] While acknowledging the higher costs of long-term wholesale funding, Deloitte stated that the business lending rate has remained relatively unchanged from July 2006 to September 2012.[52] The New South Wales Business Chamber reported that it is a widely held view among family and non-family businesses that in response to the GFC, lending conditions have become 'too strict'.[53]

8.42 The ICA also disputed the SME loan rates, noting that the RBA interest rate cuts have not been passed on in full.[54] It noted that debt finance has been difficult to access for many businesses, with banks in the current economic environment

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48 Deloitte Private, *Submission 16*, p. 28.

49 Institute of Certified Bookkeepers, *Submission 36*, p. 4.

50 FINH, *Submission 34*, p. 1.

51 Deloitte Private, *Submission 16*, p. 26.

52 Deloitte Private, *Submission 16*, p. 26.

53 Mr Paul Orton, Director, Policy and Advocacy, New South Wales Business Chamber, *Committee Hansard*, 15 November 2012, p. 17.

54 Institute of Chartered Accountants Australia, *Submission 25*, p. 6.

tightening eligibility requirements.[55] Pitcher Partners also questioned whether ADI finance appropriately takes account of family businesses' financial acumen or potential:

> [D]uring the aftermath of the GFC, many family businesses were, and are still, striking maximum lending limits that capped a bank's exposure to any one customer. These limits were often arbitrary and did not reflect the size of the business or its prospects.[56]

8.43 The committee did not receive an indication from ADIs that the finance applications of family businesses are considered separately to the finance applications of non-family enterprises. As the Agribusiness Council of Australia told the committee:

> There is a high level of indebtedness. I do not want to go into banking 101, but banks fundamentally risk rate all industries. They risk rate them based on their perceived loss. That perceived loss is not necessarily an actual loss, but they rate them and charge interest rates based on whatever the risk rating is for those particular clients. So there is the perception and there is the reality. The reality is that agriculture is not as high a risk as the banks have perceived it to be. I think the GFC has had a part to play in this in terms of banks being, not reluctant to lend, but looking more closely at their lending policies with regard to which industries they lend to and how they lend. If you had family businesses as a separate class…the banks would develop their own risk strategy around the family business category and therefore they would risk rate it accordingly.[57]

8.44 Packer Leather provided a personal account of the risk categories applied by ADIs, reporting that ADIs are very risk-averse:

> Our Australian Banks are extremely adverse to any form of risk! The risk analysis of our business – an exporter and manufacturer certainly does not give them a lot of confidence in our industry…The finance models that they use for risk assessment seemingly make no or little allowance for the personal factor – who they are supporting.[58]

8.45 However, these concerns were not shared by all family businesses that contributed to the inquiry. Mr Robert Pennicott, Managing Director, Pennicott Wilderness Journeys, described the family business sector as being in partnership with ADI sector:

> I have a bit of a philosophy with banks that we need each other…We do borrow a lot of money from one bank. We are very fortunate that we have

55 Institute of Chartered Accountants Australia, *Submission 25*, p. 6.

56 Pitcher Partners, *Submission 28*, p. 13.

57 Mr Ian Joseph, Executive Chair, Agribusiness Council of Australia Ltd, *Committee Hansard*, 7 February 2013, p. 15.

58 Packer Leather, *Submission 4*, p. 5.

> had a very good relationship with our bank and they bend over backwards to help us…personally, I think our bank has been very fair and reasonable. Obviously we can complain about fees, interest rates and everything that goes with it, but without bank assistance we would not have been able to expand in the way we have, for sure.[59]

8.46 It was further contended that the introduction of the Basel III prudential regulations would increase the cost of business finance. Developed in response to the GFC, Basel III aims to improve the banking sector's ability to absorb market shocks arising from financial and economic stress, whatever the source, improve risk management in governance and strengthen banks' transparency and disclosures.[60] As the Australian Prudential Regulation Authority (APRA) has stated, the global liquidity reforms are intended to remedy weaknesses in the international financial framework that existed at the time of the GFC:

> The Basel III capital framework was introduced by the Basel Committee on Banking Supervision in December 2010 to raise the quality and consistency of the capital base and harmonise other elements of capital. In addition, Basel III improves the risk coverage of the Basel II Framework by strengthening the capital requirements for counterparty credit risk exposures arising from banks' derivatives, repurchase and securities financing activities.[61]

8.47 However, Deloitte Private noted that measures that are intended to promote economic stability may adversely affect the financial stability of family enterprises. Citing the opinion of the NAB Chief Financial Officer, Mr Mark Joiner, Deloitte Private, advised that the impact of the Basel III capital requirements will reduce the available finance for SMEs and, accordingly, increase finance costs.[62]

8.48 The concerns raised are not unique to the family business sector. Similar concerns were raised by SME representatives during the committee's 2011 inquiry into access for small and medium business to finance. SME representatives also disputed whether the interest rates attached to SME loans actually reflect the cost of, and risks associated with, providing SME finance.[63]

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59 Mr Robert Pennicott, Managing Director, Pennicott Wilderness Journeys, *Committee Hansard*, 21 January 2013, p. 28.

60 Bank for International Settlements, 'International regulatory framework for banks (Basel III)', http://www.bis.org/bcbs/basel3.htm (accessed 21 February 2013).

61 Australian Prudential Regulation Authority, 'APRA releases final package to implement Basel III capital reforms', Media release, 13 November 2012.

62 Deloitte Private, *Submission 16*, p. 26.

63 Parliamentary Joint Committee on Corporations and Financial Services, *Access for small and medium business to finance*, April 2011, pp 24–33.

Family finance and private equity finance

8.49 The committee was informed that private equity is an underutilised financial resource for the family business sector. It was reported that family businesses are reluctant to engage with the private equity sector. According to the Council of Financial Regulators, 'private equity' encompasses two forms of investment. Firstly, private equity refers to 'venture capital'—the investment of equity funding in small and relatively high risk companies with strong growth potential. Secondly, private equity can include 'the acquisition of a public company by a group of investors who take the company ‘private’, delisting it from the stock exchange'.[64]

8.50 According to PricewaterhouseCoopers, private equity 'is a term for pools of capital, managed by professional fund management teams, specifically to invest in unlisted companies'.[65] As outlined by PricewaterhouseCoopers, in exchange for providing capital private equity firms:

- obtain a share in the company;
- typically establish closely monitored performance targets; and
- generally retain their share for three to five years. At the end of the investment period, the private equity fund will sell its share of the company to 'a suitable acquirer'.[66]

8.51 MGI's 2006 Australian Family and Private Sector Survey found that external equity is the 'least favoured' finance option for family businesses.[67] This reluctance was linked to the conservative, family-orientated nature of family businesses.[68] The committee was advised that family businesses' desire to retain control of the business acts as a significant deterrent to obtaining private equity finance. Bond University reported that numerous research projects 'have found that the financial development of family firms with regard to equity is governed by a "keep it in the family" tradition'. Bond University further advised that 'these characteristics suggest that family SMEs tend to have a more limited external equity financing base, but a wider base of internally generated equity'.[69]

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64 Reserve Bank of Australia, 'Private equity in Australia', *Financial Stability Review 2007*, March 2007, p. 59.

65 PricewaterhouseCoopers, *Private clients private business barometer—Private equity supplement – Winter 2012*, 2012, p. 4.

66 PricewaterhouseCoopers, *Private clients private business barometer—Private equity supplement – Winter 2012*, 2012, p. 16.

67 MGI Australasia, *Submission 9*, p. 8.

68 MGI Australasia, *Submission 9*, p. 8.

69 Bond University, *Submission 3*, p. 12.

8.52 Professor Ken Moores characterised the short-term focus of private equity investments as 'an anathema to the value system of a family firm'.[70] Similarly, Deloitte Private commented that the objectives of family firms are not easily reconcilable with the investment strategies underlying private equity finance. The committee was advised that the short-term, high risk outlook of private equity investment is inconsistent with the 'patient capital' approach preferred by family businesses:

> An additional hurdle to raising private equity funds for family businesses is the mechanism by which private equity investors realise their return on their investment. Private equity firms generally strive to achieve cash on cash returns of three times their investment in three to five years. Such an investment horizon and growth imperative (often coupled with a more aggressive debt appetite) is often not aligned with the goals and objectives of the family members.[71]

8.53 It was also noted that private equity investors may be reluctant to engage with family businesses. Separate to this inquiry, PricewaterhouseCoopers has noted that the 'majority of deals [by private equity firms] involve small and medium-size enterprises'. However, it defined SMEs as firms valued between $10 million and $100 million.[72] Deloitte Private told the committee that family enterprises seeking capital to fund expansion may not meet the investment criteria applied by private equity firms:

> Australian private equity firms, which could be valuable sources of equity capital for family businesses, are generally focused on larger and more mature businesses to maximise their return on investment in the current economic environment. The majority of private equity firms look for opportunities to write equity cheques starting at $10m - $20m which, combined with the leverage associated with such transactions makes the overall capital investment too large for many family businesses.[73]

8.54 It was unclear whether the family business sector's engagement with private equity differs from that of non-family businesses and SMEs more broadly. The committee was advised that 2012 research by PricewaterhouseCoopers found that there is a widespread misconception about what private equity is and the role it can play for owners considering investments and/or succession'.[74]

8.55 Nevertheless, some submitters advocated greater use of private equity by family firms. Associate Professor Pi-Shen Seet advised that private equity is

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70 Professor Ken Moores, Moores Family Enterprise, *Committee Hansard*, 16 November 2012, p. 24.

71 Deloitte Private, *Submission 16*, p. 29.

72 PricewaterhouseCoopers, *Private clients private business barometer – Private equity supplement – Winter 2012*, 2012, p. 16.

73 Deloitte Private, *Submission 16*, p. 28,

74 Associate Professor Pi-Shen Seet, *Submission 35*, p. 1.

increasingly a feature of ownership transfers of family firms in Europe and North America.[75] It was recommended that the government promote the use of private equity firms through providing information to educate family businesses on private equity options.[76]

8.56 FINH argued that the risks associated with private equity investment would be mitigated if the investor were 'another business-owning family'.[77] Professor Ken Moores put a similar proposal, referring to the benefits of a 'family office' or investment by family firms in other family enterprises:

> In the United States, for example, there is the firm of Francois de Visscher who is a Belgian by origin from a fifth generation business but operates out of Boston. He has partnered up with a Pitcairn trust and they have bought together 400 family offices and have this pool of family money. They are looking to invest in other family businesses specifically. So it is the mobilisation of that patient capital from a supply side that is looking for the demand side.[78]

8.57 To promote greater access to the private equity market, FINH recommended that:

> Government specifically look at the present incentivisation of the private equity markets and identify performance-enhancing policy measures that incorporate a greater level of knowledge of the capital needs of successful multigenerational business owning families.[79]

Access to finance: Committee view

8.58 The committee acknowledges the concerns raised with the cost of finance and the security requirements attached to business loans. On the basis of the evidence presented, family and non-family businesses can encounter similar barriers to accessing finance. The two sectors share similar concerns with the activities of ADIs and the application of prudential regulations.

8.59 However, despite the similarities, there are two points of difference. First, there appears to be greater significance attached to own-source funding. This reliance appears to be indicative of a sector that emphasises the 'family'-based nature of its economic activities. The committee notes submitters' suggestions for government to promote the private equity market. However, the committee recognises the challenges that the private equity market presents for family businesses wanting to retain control

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75 Associate Professor Pi-Shen Seet, *Submission 35,* pp 1–2.

76 Associate Professor Pi-Shen Seet, *Submission 35,* p. 5.

77 FINH, *Submission 34*, p. 2.

78 Professor Ken Moores, Moores Family Enterprise, *Committee Hansard*, 16 November 2012, p. 24.

79 FINH, *Submission 34*, p. 2.

of the business within the family, and for smaller non-family businesses. Additional information about the operation of private equity sector may assist family businesses, and the sector more broadly, to determine whether it is appropriate to seek private equity finance. This matter could be usefully considered by the Australian Securities and Investments Commission.

Recommendation 20

8.60 The committee recommends that the Australian Securities and Investments Commission review information available on the MoneySmart website about private equity investments, and design information that would assist family and non-family businesses to determine whether it is appropriate for their business to seek private equity finance.

8.61 Second, it is evident that ADIs do not consider family businesses separately from non-family enterprises when determining the risk attached to a family business' finance application. The committee considers that the integrity of the risk assessment models used by ADIs is compromised where ADIs do not accurately understand the business structures of applicants. It is of particular concern that submitters believe that ADIs do not understand the circumstances, business strategies and outlook of family businesses.

8.62 The committee extends its thanks to the CBA, CAFBA and the RBA for their contribution to the inquiry. However, the overall lack of engagement with this inquiry by the ADI sector is surprising and raises legitimate questions about the sector's understanding of family owned and operated enterprises. To ensure the efficacy of risk assessments, the committee encourages ADIs to analyse the characteristics of family businesses, as distinct from broader categories of micro, small, medium, or large businesses.

8.63 Given the apparent prevalence of family businesses in Australia's business sector, and, by extension, Australia's economy, the RBA's apparent lack of direct engagement with the family business sector must be addressed. The committee recommends that the RBA include on its annual small business panel in each state and territory representatives of the family business sector.

Recommendation 21

8.64 The committee recommends that the Reserve Bank of Australia include representatives of the family business sector on its annual small business panels as an interim measure.

8.65 The committee reiterates its 2011 recommendation that the RBA track the impact of the introduction of Basel III on the cost of small and medium business finance and residential mortgages.[80] Any improper increase in costs should be immediately addressed.

8.66 As discussed in chapter 4, should the proposed Inter-Departmental Committee (IDC) decide to gather data about the key characteristics and behaviours of family businesses, these characteristics should include the debt-to-equity ratios and the value of assets on the balance sheets of family businesses compared with non-family enterprises. As part of the IDC process, consideration should be given to gathering data on family businesses and data on non-family enterprises in the Business Finance component of the ABS Australian Business Characteristics Survey (see paragraph 4.69).

Access to insurance

8.67 The issue of family businesses' access to insurance received little attention from family businesses and family business representatives during this inquiry. Broadly, family businesses can access a range of insurance products including public liability[81] and workers compensation insurance.[82] Two points were raised regarding the sector's access to insurance.

8.68 First, Pitcher Partners and the Council of Small Business of Australia questioned whether family businesses have all the necessary and appropriate insurance cover.[83] Second, there were concerns raised with the cost of insurance. Mr David Shave of David Shave Investments Pty Ltd, reported that the cost of insurance could prohibit business expansion, advising that his business had not pursued an opportunity due to the costs associated with obtaining the required insurance.[84] Mr Robert Pennicott of Pennicott Wilderness Journeys stated that insurance and associated compliance costs are an important but costly component of running a business.[85] Pitcher Partners submitted that insurance costs may be fuelled by a lack of competition among insurance providers.[86] Family Business Australia also commented

80 Parliamentary Joint Committee on Corporations and Financial Services, *Access for small and medium business to finance*, Recommendation 2, April 2011, p. 38.

81 Institute of Certified Bookkeepers, *Submission 36*, Attachment A, p. 13.

82 Pitcher Partners, *Submission 28*, p. 13.

83 Pitcher Partners, *Submission 28*, p. 13;
Mr Peter Strong, Executive Director, Council of Small Business Australia, *Committee Hansard*, 13 November 2012, p. 26.

84 Mr David Shave, Principal, David Shave Investments Pty Ltd, *Committee Hansard*, 14 November 2012, p. 41.

85 Mr Pennicott, Pennicott Wilderness Journeys, *Committee Hansard*, 21 January 2013, p. 29.

86 Pitcher Partners, *Submission 28*, p. 13.

on the cost of insurance, but held that insurance costs could be reduced through businesses adopting more professional governance practices.[87]

8.69 However, it was widely held that family businesses can encounter the same challenges accessing insurance as non-family businesses. The Agribusiness Council of Australia argued that a business' status as a family enterprise is of little consequence to an insurance company in assessing or costing an insurance application.[88] Two family businesses also commented on whether the challenges they face differ from their non-family counterparts. There was consensus that their business' status as a family business does not affect their ability to access insurance.[89] This advice is consistent with research into the small business sector, with information provided by CCIQ indicating that the cost of insurance is a concern for both family and non-family small businesses.[90]

The family business sector's response to the global financial crisis

8.70 Neither the anecdotal nor the empirical evidence before the committee conclusively demonstrates that the family business sector outperformed non-family enterprises in response to the GFC. Nor was it established that the family business sector proved unusually resilient in response to the economic crisis. The evidence did, however, point to attributes of family enterprises that could assist businesses to respond to economic challenges.

Anecdotal views

8.71 Two markedly different pictures of the family business sector emerge from the anecdotal evidence.

A resilient family business sector

8.72 The first is a sector capable of meeting the challenges of the financial crisis. Family Business Australia reported that family businesses fared better on average than their non-family counterparts. Indeed, it argued that the characteristics that distinguish family businesses from nonfamily enterprises 'meant family businesses were bound to survive the GFC better'.[91] In particular, Family Business Australia highlighted the sector's conservative business mindset and capacity to quickly determine business

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87 Family Business Australia, *Submission 1*, p. 8.

88 Agribusiness Council of Australia, *Submission 37*, p. 8.

89 Mr Pennicott, Pennicott Wilderness Journeys, *Committee Hansard*, 21 January 2013, p. 29; Kennards Hire, *Submission 5,* p. 2.

90 CCIQ, *Submission 19*, Attachment A, p. 8.

91 Mrs Philippa Taylor, Chief Executive Officer, Family Business Australia, *Committee Hansard*, 14 November 2012, p. 35.

strategies in response to changing circumstances.[92] This view was shared by Mr Christopher Lowe, Chief Executive Officer of Bus Association Victoria, who reported that the experience of non-family businesses differed from that of family enterprises:

> I have had many a conversation with CFOs and, indeed, CEOs of global public transport operations who are feeling the pinch, who have not had a happy time through the GFC, which is in direct contrast to the feedback that I am getting back from my family business members, who are all about continuance and sustainability.[93]

8.73 Consistent with the advice of Family Business Australia, the Bus Association Victoria attributed the apparent resilience of the sector to its unique mindset:

> They have got…a resilience factor there where they are able to weather storms like GFCs. I think it comes down to their propensity to innovate and the fact that the success of the business is very much dependent upon the name of the family. All the family and those who share those family values get involved to ensure that that business is self-sustaining and self-perpetuating.[94]

8.74 Mr Des Caulfield of MGI Australasia concurred. He reported that approximately 40–45 per cent of family businesses felt supported by ADIs during the financial crisis. The committee was advised that this statistic is testament to the sector's performance:

> The fact 45 per cent of them could say that their bank has supported them is a very good indication to me that their banks actually felt they were pretty safe. I do not think the general business community would have answered in that manner.[95]

8.75 Mr Caulfield attributed the sector's resilience to its conservative business strategies and streamlined governance arrangements, which provided the flexibility to quickly respond to changing financial conditions:

> [T]hey are much more cautious than many and were therefore better placed financially to handle the downturns in turnover et cetera that occurred. Also, by their nature, they are not over-governed they make decisions relatively quickly. A lot of them—mum and dad having lunch together or

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92 Mrs Philippa Taylor, Chief Executive Officer, Family Business Australia, *Committee Hansard*, 14 November 2012, p. 35.

93 Mr Christopher Lowe, Chief Executive Officer, Bus Association of Victoria, *Committee Hansard*, 14 November 2012, p. 12.

94 Mr Lowe, Bus Association of Victoria, *Committee Hansard*, 14 November 2012, p. 12.

95 Mr Des Caulfield, Director, MGI Australasia, *Committee Hansard*, 14 November 2012, p. 25.

> the kids having lunch with them—say, 'We've got to fix this,' and they can make decisions much more quickly.[96]

8.76 Family business owners also spoke of the sector's resilience. Mrs Diane Tompson, Managing Director of Powercom Group Pty Ltd, agreed that the family business sector can readily adapt to change:

> Our accountant sums it up when he says that you have to hold your nerve in times of stress and trouble. I think that family businesses are very responsive. We are quick to respond. In fact, one of our market advantages is that we are able to build things for customers, if they want one plug or two. We can change our designs quite easily instead of only being able to produce the one product. It is no different in a so-called global financial crisis. We have not lost anybody at all. We have just had to work a bit harder. Our sales people are pretty much on board with that. They are constantly on the road trying to sell a product.[97]

8.77 Personal stories collected by Family Business Australia also linked the values and culture of family businesses to the sector's apparent capacity to withstand the GFC. Family businesses reported that 'familiness' was central to the business' success.[98] Firms reported high incidences of customer loyalty,[99] with one firm commenting that:

> times are still tough. "But we're well positioned so that when times are better, as someone who continued to support the industry through the tough times, we will be rewarded accordingly".[100]

8.78 Interestingly, not all family businesses shared the view that family involvement safeguarded the business against the GFC. Mr Alan Berechree, the owner of a Burnie Newsagency, reported that the business 'really had not had much of a downturn' in response to the GFC. However, the continued profitability of the business was attributed to the nature of the industry rather than any family-based characteristics.[101]

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96 Mr Caulfield, MGI Australasia, *Committee Hansard*, 14 November 2012, p. 24.

97 Mrs Diane Tompson, Managing Director, Powercom Group Pty Ltd, and Family Business Australia, *Committee Hansard*, 21 January 2013, p. 38.

98 Technigro, as cited in Family Business Australia, *Soul stories*, Free Run Press Pty Ltd, Kent Town, 2012, p. 188.

99 Vellex, as cited in Family Business Australia, *Soul stories,* p. 206; Tobin Brothers, as cited in Family Business Australia, *Soul stories*, p. 194.

100 WSL – Wine Storage and Logistics, as cited in Family Business Australia, *Soul stories*, p. 216.

101 Mr Alan Berechree, Owner, Burnie Newsagency, *Committee Hansard*, 21 January 2013, p. 20.

A contrary view: the family business sector's shared experience

8.79 In contrast to the view of the sector as resilient, there is also evidence that the sector was adversely affected by the GFC. The CCIQ acknowledged that the family business sector was 'not immune' from the effects of the global financial crisis.[102] The Institute of Chartered Accountants wrote in its submission that 'the post GFC environment has presented challenges for family businesses as it has for many other forms of business in the economy'.[103] Somewhat pessimistically, Pitcher Partners reported:

> [l]ike all business cycles that have preceded it, the GFC and post-GFC has, and will continue to, claim victims among family businesses in Australia. Family businesses accept the risks of failure at this time but that knowledge does not ease the pain, suffering and personal anguish that is experienced when it actually happens. Business failure will often cause a breakdown of the family unit leading to divorce, extreme financial hardship, and division of families.[104]

8.80 Family businesses also commented that the GFC adversely affected business profitability. The multi-generational Queensland firm, Packer Leather, noted that the global economic downturn had a measurable impact on family businesses operating in international markets.[105] Mr Raymond Hind, Chief Executive Officer of the Western Australian firm Hind's Transport Services, told the committee:

> [t]he difficulty now, after the GFC, is obtaining finance. So we are finding that we are putting a lot of our own money back into the business for it to survive because of the inability to raise finance.[106]

8.81 However, the demarcation between the experience of family and non-family businesses is again not clear. The anecdotal evidence focused on the family business sector as a subset of the SME sector. For example, the Institute of Certified Bookkeepers reported that 'SMEs are doing it tough'.[107] BusinessSA also grouped family businesses with SMEs, advising that the 'GFC hurt consumer and business confidence, affecting many businesses including family businesses'.[108]

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102 CCIQ, *Submission 19*, p. 2.

103 Institute of Chartered Accountants Australia, *Submission 25*, p. 6.

104 Pitcher Partners, *Submission 28*, p. 15.

105 Packer Leather, *Submission 4*, p. 6.

106 Mr Raymond Hind, Chief Executive Officer, Hind's Transport Services, *Committee Hansard*, 7 February 2013, p. 23.

107 Institute of Certified Bookkeepers, *Submission 36*, p. 4.

108 BusinessSA, *Submission 23*, p. 2.

Empirical evidence - conflicting data

8.82 The challenge of identifying the family business sector's response to the GFC is complicated not only by the heavy reliance on often conflicting anecdotal evidence, but also by inconsistent empirical data.

Statistics that support the view that the family business sector was uniquely placed to respond well to the global financial crisis

8.83 Several witnesses drew attention to the 2009 KPMG survey as evidence that the family business sector successfully weathered the GFC.[109] The 2009 KPMG survey of approximately 457 entities self-identifying as family businesses found that while over half expected negative or low growth in the coming 12 months, over 90 per cent reported being well-prepared or moderately well prepared to face changes over the coming year. Accordingly, KPMG concluded that '[m]any family businesses appear to have shrugged off credit and finance constraints' resulting from the GFC.[110] Reporting in 2011, KPMG subsequently noted that '56 per cent of survey respondents agreed that being a family businesses helped them deal with the post-GFC economic downturn while only 10 per cent actually disagreed with this proposition (the remainder were unsure)'.[111]

8.84 Moores Family Enterprise cited the KPMG survey's results as evidence that 'many family businesses appear to have shrugged off credit and finance constraints'.[112] The findings also attracted media attention, with the *Herald Sun* reporting in 2009 that '[m]ost family businesses felt little or no effect from the tougher credit conditions during the economic slowdown, KPMG research has found'.[113]

Contrary data

8.85 However, as Dr Chris Graves, Professor Mary Barrett and Dr Jill Thomas noted, findings about the resilience of the family business sector are 'difficult to

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109 Moores Family Enterprise, *Submission 8*, p. 6. Dr Chris Graves, Family Business and Education and Research Group, University of Adelaide, Professor Mary Barrett, School of Management and Marketing, University of Wollongong, Dr Jill Thomas, Family Business Education and Research group, University of Adelaide, *Submission 14*, p. 5.

110 KPMG and Family Business Australia, *KPMG and Family Business Australia Survey of Family Businesses 2009*, 2009, p. 5.

111 KPMG and Family Business Australia, *Stewards: Moving Forward, Moving Onward – KPMG and Family Business Australia's Family Business Survey 2011*, 2011, p. 8.

112 Moores Family Enterprise, *Submission 8*, p. 6.

113 Rachel Hewitt, 'Family businesses weather the financial crisis', *Herald Sun*, 12 October 2009, http://www.news.com.au/business/worklife/family-businesses-weather-the-financial-crisis/story-fn3p68a7-1225785663194 (accessed 26 February 2013).

empirically verify'.[114] Deloitte Private observed 'there is very little data to make an informed response to this term of reference'.[115] Both submitters called for additional research to determine the sector's response to the GFC and whether there are broader lessons for Australia's business sector.[116]

8.86 Additionally, findings vary across data sources. The optimistic findings of KPMG can be compared with the results of MGI Australasia's 2010 Australian Family and Private Business Survey. The survey found that the GFC adversely affected 35.7 per cent of family businesses, leading to unspecified 'cost cutting' activities by slightly over 50 per cent, delays in hiring staff by 34.5 per cent, and postponing expansion plans by 26.9 per cent of the businesses surveyed.[117] Securing adequate capital for growth and retirement was among the top four concerns reported.[118] On the basis of this data, it was concluded that the concerns of family business owners about the future of their businesses has generally risen since 2006, with the family business sector's confidence declining as a result of the GFC.[119] According to MGI Australasia, the GFC weakened the sector's performance and confidence:

> Today, as Australia disentangles itself from the grip of the Global Financial Crisis (GFC), the current survey shows that family businesses have changed from pre-GFC days. Despite Australia having weathered the GFC better than most countries, the concerns of family business owners about the future of their businesses has generally risen since 2006, the date of the previous survey. More business owners are significantly more concerned about competition, funding for growth and for the future of their particular industry than they were in 2006 and 2003.
>
> The survey reveals a less confident family business sector post-GFC than pre-GFC – with family business owners more reliant on the continuity of

114 Dr Chris Graves, Family Business and Education and Research Group, University of Adelaide, Professor Mary Barrett, School of Management and Marketing, University of Wollongong, Dr Jill Thomas, Family Business Education and Research group, University of Adelaide, *Submission 14*, p. 5.

115 Deloitte Private, *Submission 16*, p. 30.

116 Deloitte Private, *Submission 16*, p 30; Dr Chris Graves, Family Business and Education and Research Group, University of Adelaide, Professor Mary Barrett, School of Management and Marketing, University of Wollongong, Dr Jill Thomas, Family Business Education and Research group, University of Adelaide, *Submission 14*, p. 5.

117 Kosmas Smyrnios and Lucio Dana, *The MGI Family and Private Business Survey: 2010*, July 2010, p. 15.

118 Kosmas Smyrnios and Lucio Dana, *The MGI Family and Private Business Survey: 2010*, July 2010, p. 15.

119 Kosmas Smyrnios and Lucio Dana, *The MGI Family and Private Business Survey: 2010*, July 2010, p. 4.

> their business to fund their retirement and more concerned over the future of their business.[120]

8.87 The committee did not receive evidence on this point from ADIs or the RBA. However, some empirical information is available from international sources. As the committee reported in April 2011,[121] the Organisation for Economic Co-Operation and Development (OECD) concluded that Australia's financial system 'proved very resilient during the global crisis'. As the OECD reported:

> [t]he performance of the Australian economy has remained solid. It weathered the world financial and economic crisis better than most of the OECD countries and, indeed, and avoided a recession...In contrast to most other OECD countries, the short-term outlook is favourable.[122]

8.88 In part, this was attributed to 'solid domestic banking supervision'. As the OECD noted, Australia's '[b]anks have remained profitable with stable capital ratios, and the largest Australian banks are now among the soundest in the world'.[123] Other factors the OECD cited were 'the dynamism of Asian markets [and] well-functioning financial and labour markets and the timely and strong policy response to the crisis'.[124]

The mindset of family businesses – lessons for the broader economy?

8.89 While neither the anecdotal nor the empirical evidence clearly demonstrated that family businesses outperformed non-family enterprises, the data did reveal key features of family businesses that may enhance financial stability. The European Commission's review of the family business sector in Europe found that in general family businesses are risk-averse and focus on 'long-term sustainability rather than the realisation of short-term profits'.[125] Statistical research in the Australian context has highlighted similar investment trends among Australian-based family businesses. On the basis of its 2009 survey, KPMG concluded that '[f]amily businesses generally take a more conservative financing approach and long-term are more likely to have a 'patient capital' financial outlook'. This approach was considered to have assisted the

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120 MGI Australasia, *Family business owners concerned about their future post the global financial crisis*, http://www.mgiaust-survey.com/articles/family-business-owners-concerned-about-their-future-post-global-financial-crisis (accessed 26 February 2013).

121 Parliamentary Joint Committee on Corporations and Financial Services, *Access for small and medium business to finance*, April 2011, pp 29–30.

122 Organisation for Economic Co-Operation and Development, *OECD Economic Surveys, Australia: Volume 2010/21, Supplement 3 – Overview*, p. 3.

123 Organisation for Economic Co-Operation and Development, *OECD Economic Surveys, Australia: Volume 2010/21, Supplement 3*, p. 12.

124 Organisation for Economic Co-Operation and Development, *OECD Economic Surveys, Australia: Volume 2010/21, Supplement 3 – Overview*, p. 3.

125 European Commission and the Austrian Institute for SME Research, *Overview of family business relevant issues – Final report*, 2008, p. 56.

family business sector to withstand the GFC.[126] Anecdotal evidence collected by Family Business Australia also highlighted that family firms attributed resilience to 'long-term investments rather than a short-term view'.[127]

8.90 Mr Francesco Barbera of Bond University commented on his research findings suggesting that family businesses adopt a 'patient capital' approach to business planning:

> [F]amily firms tend to have a longer term time horizon and strategic planning happens over multiple generations rather than simply in the short run. In fact, a couple of weeks ago I interviewed a company which during the financial crisis spent most of their time buying assets rather than selling. That was because they recognise the good price currently and realise they are in business for the next 20, 40 or 60 years so now would be a good time to buy. But a non-family firm might not necessarily have such a long time horizon. It might have investors who are demanding dividends and liquidation of assets rather than the purchasing of assets, for example.[128]

8.91 As chapter 4 of this report has noted, family businesses tend to minimise debt and maximise their asset base.[129] KPMG argued that this approach to business management gives family businesses a competitive advantage over non-family entities, and provided family businesses with a sound economic basis on which to operate throughout the GFC:

> As they tend to take the longer term view; interested in growing the family wealth and having a different set of strategic goals compared to non-family and private companies, their long-term economic contribution is significant, and will be increasingly so. For many family businesses the ability to plan long-term can give them a huge competitive edge, allowing them to be more innovative than the corporate sector…A strong focus towards cash reserves are also qualities that will continue to give traditional family businesses a genuine competitive edge in the marketplace as the global economy recovers.[130]

8.92 Mrs Genevieve Power of the Canberra-based firm Iken Commercial Interiors, advised that a reliance on 'patient capital' and asset accumulation provided family businesses with financial stability despite the challenges presented by the GFC:

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126 KPMG and Family Business Australia, *KPMG and Family Business Australia Survey of Family Businesses 2009*, 2009, p. 5.

127 Hawkins Family Group, as cited in Family Business Australia, *Soul stories*, p. 104.

128 Mr Frank Barbera, *Committee Hansard*, 16 November 2012, p. 39.

129 See, for example, Dr Chris Graves, Family Business and Education and Research Group, University of Adelaide, Professor Mary Barrett, School of Management and Marketing, University of Wollongong, Dr Jill Thomas, Family Business Education and Research group, University of Adelaide, *Submission 14*, p. 5.

130 KPMG, *Submission 21*, p. 22.

> Good family businesses have strong assets. Whether they are liquid assets, in terms of stocks and shares, property assets or whatever assets, family businesses are asset based businesses. Therefore, in a crisis you rely on those assets to support your borrowings from the bank or you go to the bank and put up more assets to borrow more or you sell off those assets to enable you to continue to operate the business.[131]

8.93 Several submitters also commented on the personal commitment to the business displayed by family business owners. Mrs Power commented that this personal commitment enabled family businesses to better respond to the GFC:

> Combined with passion and commitment, and a bit of 'We won't let the buggers beat us; we'll keep going,' you reduce every cost you can, you ask your staff to recycle every piece of paper and you do absolutely everything you can to reduce every cost.[132]

8.94 Chapter 4 identified that family businesses' personal and long-term commitment to the business promotes a long-term view of financial gain. It was argued that this commitment is common among family businesses and is atypical of managers and directors of non-family companies. As Deloitte Private stated, 'owners will accept more modest growth in the longer term returns to ensure the sustainability of the business rather than relentlessly strive for short-term results'.[133]

8.95 These views are consistent with international research which indicates that the long-term focus of family businesses leads to risk averse investment strategies and 'significantly lower leverage than non-family firms'.[134] Nicolas Kacher, George Stalk and Alain Bloch wrote in a November 2012 *Harvard Business Review* (HBR) article that based on their research:

> …during good economic times, family-run companies don't earn as much money as companies with a more dispersed ownership structure. But when the economy slumps, family firms far outshine their peers. And when we looked across business cycles from 1997 to 2009, we found that the average long-term financial performance was higher for family businesses than for nonfamily businesses in every country we examined.[135]

8.96 Kacher, Stalk and Bloch found that the factors that contribute to this performance include:

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131 Mrs Genevieve Power, Managing Director, Iken Commercial Interiors, *Committee Hansard*, 13 November 2012, p. 51.

132 Mrs Power, Iken Commercial Interiors, *Committee Hansard*, 13 November 2012, p. 51.

133 Deloitte Private, *Submission 16*, p. 13.

134 Mr Francesco Barbera and Professor Ken Moores, 'Firm ownership and productivity: a study of family and not family SMEs', *Small Business Economics*, Vol. 29, October 2011.

135 Nicolas Kacher, George Stalk and Alain Bloch, 'What you can learn from family business', *Harvard Business Review*, November 2012, pp 103–106.

- a focus on resilience rather than short-term performance;
- low levels of debt and judicious capital expenditure;
- avoidance of risky ventures, desiring to 'forego the excess returns available during good times in order to increase the odds of survival during bad times'; and
- the personal investment by chief executive officers, who often adopted a 10–20 year investment horizon (see chapter 4).[136]

8.97 These characteristics can be contrasted with the business strategies that the OECD concluded contributed to the GFC. In 2009, the OECD Steering Group on Corporate Governance released its report *The Corporate Governance Lessons from the Financial Crisis*,[137] which outlined concerns that corporate governance structures did not safeguard against excessive risk-taking in a number of financial companies. The report points to concerns with the asset holdings of companies and remuneration systems that encouraged and rewarded high levels of risk-taking behaviour.[138]

8.98 The authors of 2012 HBR article concluded that 'well-run family businesses can serve as role models' for non-family enterprises.[139] The researchers concluded that a 'patient capital' approach is a sound model through which to respond to economic crisis:

> [T]he resilience–focused strategy of family-owned companies may become more attractive to all companies. In a global economy that seems to shift from crisis to crisis with alarming frequency, accepting a lower return in good times to ensure survival in bad times may be a trade-off that managers are thrilled to make.[140]

Employment and the global financial crisis

8.99 The committee heard that stable employment within the family business sector may have assisted family enterprises to respond to the GFC. Mr Barbera told the committee:

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136 Nicolas Kacher, George Stalk and Alain Bloch, 'What you can learn from family business', *Harvard Business Review*, November 2012, p. 104.

137 OECD Steering Group on Corporate Governance, 'The Corporate Governance Lessons from the Financial Crisis', 11 February 2009, ISSN 1995–2864, *Financial Market Trends*, Vol. 1, 2009.

138 OECD Steering Group on Corporate Governance, 'The Corporate Governance Lessons from the Financial Crisis', 11 February 2009, ISSN 1995–2864, *Financial Market Trends*, Vol. 1, 2009, pgs 3 and 5.

139 Nicolas Kacher, George Stalk and Alain Bloch, 'What you can learn from family business', *Harvard Business Review*, November 2012, p. 104.

140 Nicolas Kacher, George Stalk and Alain Bloch, 'What you can learn from family business', *Harvard Business Review*, November 2012, p. 106.

> As far as their capacity to withstand economic crisis is concerned, I am looking into that at the moment. One of the arguments is that employment—and you said it yourself—is much more stable in those family firms because they are more reluctant to lay off staff during tough times.[141]

8.100 This position was supported by Mr Graham Henderson, a managing director of a third-generation family business. He advised that family businesses have the capacity to remain stable despite volatile financial circumstances:

> Family businesses can respond to the challenges of the global financial crisis and of resilience. We are not inclined to put off people or to get rid of employees. You only have to look in the media most days to see ANZ getting rid of 600 people or Qantas getting rid of 500 people. That is not our make-up. Our make-up is we value our employees and we try to protect our employees and keep them on in very difficult circumstances. We have this positive attitude that things are going to get better, and we would rather keep these people on and support them so that when things get better we can fly off a lot earlier than the bigger people who are saying, 'I think we should rehire'.[142]

8.101 CCIQ commented:

> Time and again we see a spectrum of behaviour in terms of business. They will cut discretionary expenditure, they will cut advertising and they will cut training, but one of the very last things they do before they have to physically close is let go of their employees. It is really the second-last trigger point for most businesses.[143]

8.102 However, the Chamber also observed that family businesses are prepared to cut staff if necessary:

> [T]here is definitely a willingness—nobody wants to see their family business go under; they feel responsible. I think that in turn results in a greater tenacity. When it is a choice between sink or swim, if it means having to let some staff go then family businesses—and small businesses—generally are prepared to make the necessary decisions. Nobody likes to fire people. Nobody likes to risk being uncompetitive. But it is a reality of running a business, and I think family businesses understand that better than

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141 Mr Francesco Barbera, PhD Scholar and Adjunct Lecturer, Faculty of Business, Bond University, *Committee Hansard*, 16 November 2012, p. 3.

142 Mr Graham Henderson, Director, Family Business Australia, *Committee Hansard*, 14 November 2012, p. 43.

143 Ms Sophie Andrew, Senior Policy Analyst, Chamber of Commerce and Industry Queensland, *Committee Hansard*, 16 November 2012, p. 3.

> anybody. That has certainly become apparent to us in conducting our case studies.[144]

8.103 The anecdotal evidence suggests that in addition to a preference to retain staff, family businesses owners are prepared to reduce their salaries, while staff in these businesses forego higher earning opportunities elsewhere. Mrs Power told the committee that in response to crisis, family businesses restrict expenditure: 'You do not pay yourself or you take half salary or only what you need to live on'.[145] The personal stories collected by Family Business Australia included reports that family members remain with the business in times of financial difficulty, accepting lower wages than they could receive elsewhere.[146] Mr Barbera described the family business sector as 'a more flexible labour force which is willing to work for less money if need be'.

8.104 The New South Wales Business Chamber speculated that access to unpaid labour assisted family businesses to meet the financial challenges of the GFC. Mr Paul Orton told the committee:

> I think the ownership plus operational responsibility means that the business has a life beyond simply the set of books. It is a big part of individuals' and families' reasons for being, in a sense, and I am sure that they have done things that may not necessarily have stacked up, in strict financial terms, to ensure the businesses were in a position to survive and prosper beyond the GFC.[147]

8.105 The Chamber also explained that the 'measures that may not necessarily have stacked up in strict financial terms' may have included access to free family-based labour:

> Part of it is simply that businesses that have a lot of family members involved can probably rely on those family members to support the business, even when there is not a great deal of access to cash flow or much by way of sales coming in. It is much more difficult, I suppose, if a business has to rely on employees that it pays, to wind things back or ramp them up. It is a lot less flexible for businesses that have those formal employee-employer relationships more to the fore.[148]

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144 Ms Sophie Andrew, Senior Policy Analyst, Chamber of Commerce and Industry Queensland, *Committee Hansard*, 16 November 2012, p. 3.

145 Mrs Power, Iken Commercial Interiors, *Committee Hansard*, 13 November 2012, p. 51.

146 Decorative Imaging Pty Ltd, as cited in Family Business Australia, *Soul stories*, p. 62.

147 Mr Paul Orton, Director, Policy and Advocacy, New South Wales Business Chamber, *Committee Hansard*, 15 November 2012, p. 22.

148 Mr Tim Hicks, Policy Adviser, Business, Regulation and Economics, New South Wales Business Chamber, *Committee Hansard*, 15 November 2012, p. 22.

8.106 CCIQ also hinted at this practice, providing an example of a family business that, in response to the GFC, 'fired only non-family members'.[149] It added:

> [i]t also poses an interesting question about whether or not those family members who work in a family business see themselves as operating outside of the Fair Work Act and, accordingly, are prepared to take what would not be considered to be a wage and would forgo income with a view to supporting that business through difficult times.[150]

8.107 The committee was also advised that family businesses may perceive the business operates outside the parameters of the *Fair Work Act 2009*:

> [M]any members who work in a family home business are effectively shareholders in that business and, accordingly, are prepared to forgo an income to ensure that that business prevails through a difficult operating environment. I would hazard a guess—it would need to be confirmed—that award rates of pay would not be considered of relevance to many family members. So clearly they do operate outside of the Fair Work Act.[151]

The global financial crisis and the family business sector: Committee view

8.108 On the basis of the available evidence, it cannot be concluded that the family business sector in Australia outperformed non-family businesses in response to the GFC. There is strong anecdotal evidence that a number of family businesses performed well, and the committee recognises the conviction underlying statements by family business representatives that the sector proved particularly resilient in response to the GFC. However, there is little empirical data to support a conclusion that the sector's performance eclipsed that of non-family enterprises.

8.109 There are aspects of the mindset of family businesses that could allow them to respond to periods of financial instability. The committee notes arguments that a patient capital approach safeguards businesses from economic downturn and the OECD's conclusions highlighting the drawbacks of risky, highly leveraged investments.

8.110 The committee believes that the patient capital approach is a remedy against business closures in the event of economic instability. An analysis of the family business sector's response to the GFC indicates that this approach has distinguished many family businesses from non-family enterprises. The sector's contribution to the Australian economy includes the promotion of the benefits of a risk-averse, long-term approach to investment and business profitability (see also chapter 4). While its

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149 Ms Sophie Andrew, Senior Policy Analyst, Chamber of Commerce and Industry Queensland, *Committee Hansard*, 16 November 2012, p. 3.

150 Mr Nick Behrens, General Manager, Advocacy, Chamber of Commerce and Industry Queensland, *Committee Hansard*, 16 November 2012, p. 3.

151 Ms Sophie Andrew, Senior Policy Analyst, Chamber of Commerce and Industry Queensland, *Committee Hansard*, 16 November 2012, p. 3.

effects have not been measured, the committee considers that it is an approach that the broader economy could consider.

8.111 The committee considers that family businesses' patient capital approach warrants further analysis. It reiterates that the proposed IDC should give consideration to whether data should be collected on family businesses' debt to equity ratios and the value of assets on balance sheets (see recommendation 10).[152] This information would be useful in identifying the conservative, long-term investment focus of the sector.

8.112 The anecdotal evidence that family businesses may perceive that they operate outside the parameters of the Fair Work Act is of concern. That said, the evidence on the employment practices of family businesses is inconclusive. It is insufficient to draw conclusions about the extent to which non-compliance with employment requirements may be occurring.

152 See Recommendation 7, chapter four.