September 2017

# *Once in a lifetime*

## Australia's intergenerational succession

www.pwc.com.au/onceinalifetime

*Australian private and family businesses are in the midst of a once-in-a-generation event.*

Over the next few years, a significant amount of responsibility and wealth will change hands as owners retire, sell up, or pass the reins on to the next generation.

Getting this transfer right is one of the biggest challenges facing both business owners and the broader economy. If managed well, it could underpin a new wave of prosperity and growth for Australia. But if mishandled, it could result in a significant destruction of value, erosion of the tax base, loss of employment, and in turn, less money for social services such as infrastructure, hospitals and schools.

We already know that the Australian sector is unique, with our latest research showing Australian business owners are almost twice as likely to sell their business compared with their global counterparts. Our 'Once in a lifetime' series shines a light on the Australian private and family business landscape, providing insight into the key issues, opportunities and outcomes for the sector.

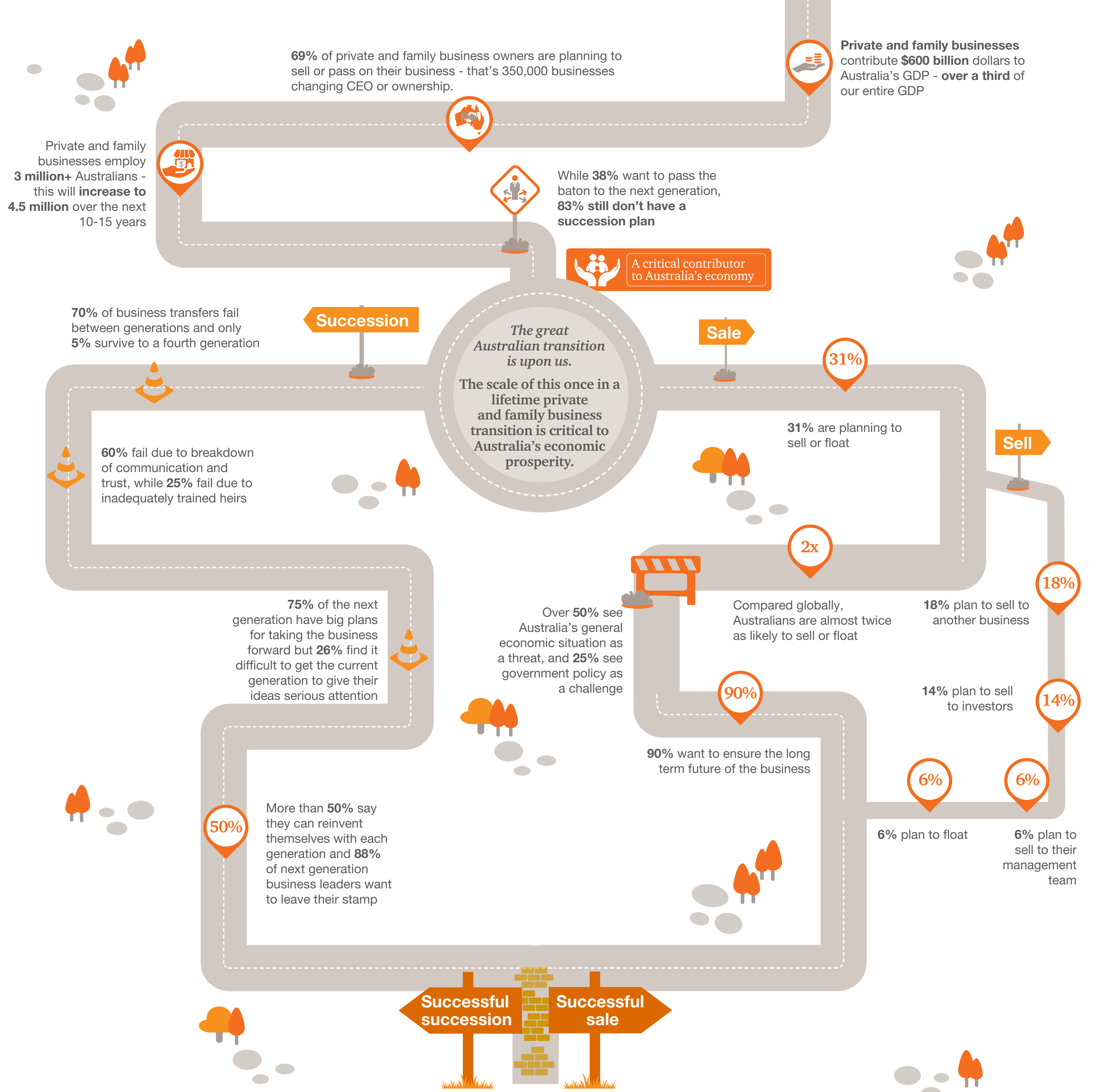
In this report, we set the scene by exploring the drivers behind the great Australian wealth transfer and outlining what's at stake. We discuss the different paths retiring or exiting business owners are taking, share their experiences, and offer guidance on what owners need to do to make sure their next move – succession or sale – is a success.

Getting this once in a lifetime opportunity right is in everyone's interest.

*Sanjv Jeraj*

**Private Clients Leader**
**PwC Australia**

*Australia's private and family business sector plays a fundamental role in Australia's economy and society. As the custodians of these businesses reach retirement age, ensuring the ongoing success of their businesses is crucial to Australia's prosperity.*




Source: Data is sourced from research undertaken for the PwC Family Business Survey (2016), the PwC Next Gen Survey (2017); and PwC economic modelling.

# Why successful transfers matter

Private and family businesses

Contribute
**$600bn**
to Australia's GDP

Employ almost
**3 million**
Australians

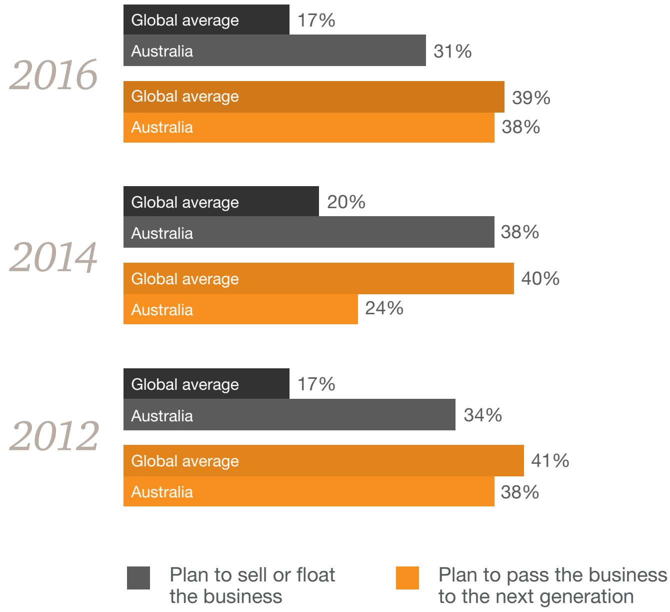
*PwC's latest Family Business Survey highlights that more than two-thirds (69 per cent) of Australian family businesses plan to either sell their business or pass it on to the next generation.*

These transfers will have a major impact on Australia. Economic modelling by PwC confirms that private and family businesses are the backbone of the economy, contributing over $600 billion to our national GDP and employing almost 3 million Australians.

But while family and private businesses are skilled at creating wealth, they're less accomplished at passing it on. Our experience shows that around 70 per cent of business and wealth transfers fail when moved between generations. There are also considerations to take into account when a business is sold or changes hands.

Australia's continued economic prosperity is closely tied to making sure the transfer of family and private business legacy set to take place over the next decade – and that which is already underway – is successful.

### What are your future ownership plans for the business?




## *Demographics and exits are driving transfers*

So what's behind the great Australian wealth transfer? The key driver is Australia's ageing population. As explored in the report *'An Ageing Australia: Preparing for the Future'*, the population aged 75 years or more is expected to rise by 4 million between 2012 to 2060, increasing from about 6.4 to 14.4 per cent of the population.[1]

Family businesses will feel the impact of this demographic shift more than most as they already have a high proportion of older owners. Data published by the Australian Taxation Office shows that the median age of the group head is higher than that of non-family businesses, with 30 per cent being more than 70 years of age.[2]

We are also seeing a large number of first generation owners, typically baby boomers around 50-60 years of age, looking to sell their businesses and realise the wealth they have worked hard to create.

As more and more business owners look to retire, hand over the reins or exit, there will be a marked increase in the number of businesses for sale and the number of transitions to the next generation.

### What's the trend for succession?

*31%*


of family businesses are **planning to sell or float their business** while...

*38%*

plan to pass it onto the next generation

1 Productivity Commission, 2013, *An Ageing Australia: Preparing for the Future,* accessed 20 September 2017 www.pc.gov.au/research/completed/ageing-australia

2 Australian Taxation Office, 2016, *Privately owned and wealthy groups demographics*, accessed 20 September 2017 www.ato.gov.au/Business/Privately-owned-and-wealthy-groups/What-you-should-know/About-privately-owned-and-wealthy-groups/Privately-owned-and-wealthy-groups-demographics/

*"Transferring business ownership is one of the biggest challenges facing individuals and business owners, and the broader Australian economy."*

Sanjiv Jeraj
Private Clients Leader,
PwC Australia

## *Growth, wealth and jobs at stake*

Australia's private and family businesses are a growth engine for the Australian economy. Our economic modelling predicts that in the next five years, around 350,000 private and family businesses will change leadership, transition ownership, or move overseas. Our modelling further shows that in Australia, an estimated 3 million employees will directly feel the impact of this business and wealth transfer. Over the next decade, the number of affected employees will increase to almost 4.5 million.

With so much value at stake collectively, poorly planned or executed transfers will not just have an impact on the rate of family business failure post succession. It could have a significant impact on productivity, employment, and the broader Australian economy.

If mismanaged, this transition could lead to a significant erosion of the tax base, resulting in less money for important services to keep our economy and society strong. And because capital is very portable, we may see substantial investable wealth leave Australia, attracted by other countries offering incentives such as tax breaks, or indeed, through the sale of Australian businesses to foreign investors.

Family and private businesses are unique in that they occupy almost every segment and industry of our economy. They can also invest for the long term as they are not dominated by short-termism, unlike many public companies. If these businesses – or the proceeds from their sale – aren't transferred strategically and successfully, there is a huge risk Australia will lose a significant store of specialist skills, knowledge and capital.

## *Getting it right*

Ensuring the successful transfer of businesses and wealth, on the other hand, will have many positive impacts.

It will support the continued growth of the family and private business sector, the backbone of the Australian economy. It will invigorate the economy with new capital, new ideas and new jobs, and will help underpin the tax base.

If transfers are well managed, starting a family business, or transforming an existing business to align with changing market demands, will become a more attractive prospect to younger generations and new entrepreneurs. Family and private businesses will find it easier to attract and retain the right talent and skills and to create new business opportunities for themselves and others.

Importantly, successful transfers will have a positive impact on the well-being of families involved in family and private businesses. It will help ensure harmony and continuity, make it easier to protect close relationships, and facilitate succession and wealth planning.

*Our profiling shows*

# *3 million employees*

*will feel the impact of intergenerational succession and a change in ownership – or indeed the closure of the business – first hand.*

*Over the next decade, the number of affected employees will increase to almost* ***4.5 million***

# Plan to get the most from your one and only exit


Australian businesses are nearly **twice** as likely to sell or float as their global counterparts

*You only get one chance to sell your business. For many owners, the sale represents the culmination of a lifetime's work. It's worth putting in the time and resources to get it right.*

In our experience however, most private and family business owners don't prepare well enough for sale. It's understandable – the knowledge and skills required to sell your business can be quite different to those needed to operate it.

But poor exit planning has consequences, which can be financial or personal – or both. The following insights will help you make the most of the once-in-a-lifetime event.

“

*You get one chance, really, at selling your business and selling it well.”*

Alan Elliott, Partner, PwC Australia

## *A strong and open market means opportunity*

Over the last four to five years, the market for private and family business sales has been steadily strengthening, and valuations are on the rise. The growing number of businesses being offered for sale – driven by demographic change – is being matched by an equally strong level of demand from both domestic and international buyers, both trade and private equity. In other words, it's a good time to be selling your business.

Another factor driving prices has been the 'openness' of the Initial Public Offering (IPO) market for medium size private businesses. Listing your business on the stock market can sometimes deliver a higher valuation than a private treaty sale. For this reason, many owners are rightly considering whether an IPO is suitable for them, although an IPO 'exit' comes with its own risks and complexities that can make it less attractive as an option. This can include 'market risk', meaning the risk of market conditions impacting on the IPO price and/or the ability of the IPO to successfully complete; as well as an IPO exit typically only involving a partial sell down by the current owners.

The 'buyer universe' also includes private equity funds, which are injecting additional capital, as well as strategic and operational know-how, into private businesses in order to accelerate their growth trajectories and investment returns. Owners are taking advantage of the opportunity to partner with private equity by selling down part of their ownership now and sharing in the enhanced return down the track when they sell out completely.

Regardless of which path you decide to take, the key to a successful sale lies in preparation and planning.

## *Don't forget to plan for the personal*

Having a plan to get your business in good financial shape, and with a clear and coherent strategy, is one of the key ingredients to ensure you can maximise your return. But all too often, owners overlook the impact the sale will have on their personal lives, and the lives of their family. This matters whether the family is involved in the business or not.

In our experience, owners and their families face two major 'personal' challenges as a result of a business exit.

The first is dealing with the large increase in wealth that usually accompanies the sale. New wealth can affect owners and their families in very different ways, not all of them good. There's even a term for it 'sudden wealth syndrome', and it can wreak havoc on families, relationships and personal well-being.

Preventing sudden wealth syndrome requires careful planning. Well before you sell your business, think about how you will distribute your wealth, how you might invest and spend it, and how you will pass it on to the next generation. Above all, make sure you take family objectives and 'values' into account prior to embarking on a path to sale; small differences now can make a big difference later. It's also worth getting advice to help you work through these important personal questions objectively.

The second challenge is dealing with the impact of waking up one day and not having the business around. For many owners, and in some cases their families too, the business has been a major part of their lives for many years, sometimes decades. And even though they may have been dreaming about retirement for some time, the sudden absence of the business can have an unexpected and profound impact on their sense of purpose, identity and well-being.

It's important to start thinking about these things early so that you can properly 'separate' yourself from the business by the time it sells. Also, reflect on the post-business goals you want to achieve and how you want to spend your time.

Debbie Hill, Director of Supagas - an Australian-based gas supply business - wasn't prepared for the emotional impacts to stem from the sale of the family business in 2016. Although selling wasn't the initial preference for Debbie or her father, who founded the business with his two brothers in 1968, it was simply getting too big to be confined within the family walls.

In the end, the decision to sell was made because it was "the right time for the business, and the right time for the people in the business", says Debbie. So what allowed for a successful transaction? Debbie credits open, honest and consistent communication – and even debate on business matters – between family members.

Given her time over, Debbie says planning for the business' succession early would definitely be a priority.

"Refining the day-to-day financial reporting and operating systems to ensure the drivers and levers in the business are clearly presented is critical", she said. "It's so important to make your business easy to understand for someone new, looking at it through a typical deals lens. Even these simple things could make or break a deal with a potential buyer."

## *Understand what your business is really worth*

Owners know their business better than anyone. But when it comes to working out what someone might be willing to pay for it, valuations – and expectations – can vary wildly.

Valuation is in the eye of the beholder, and different buyers may pay more or less for a business depending on their own perceived value of it. To ensure an orderly sale, owners should take the time to get a realistic perspective on the market value of their business and who the 'natural buyers' are to engage with (and whether or not an IPO is a viable option for their own specific circumstances).

A common valuation methodology for 100 per cent of the shares of a company is typically described along the following lines:

**('normalised' EBITDA* x multiple) less (net cash minus 'debt').**

*Earnings before interest, taxes, depreciation and amortisation

The *multiple* is a function of several things: market growth and risk dynamics, expected future earnings growth rate, confidence in the sustainability of future cash flows, and the scale and strength of the business and its risk characteristics. Private and family businesses in more traditional industries, with turnover in the $10 - $200 million range, typically attract a *multiple* in the 3-7 range.

The good news is that all of the factors that affect the *multiple* can be worked on and improved in the lead up to a sale. For example, businesses that have corporatized, and where goodwill has moved from the entrepreneur to the business, generally get a higher multiple than businesses that may be more profitable but are reliant on the owner.

Here are the top ten things you can start doing now to prepare your business for sale and make sure you maximise business value.

## *Top 10 tips for preparing to exit your business*

### *1. Take your time*

You will generally achieve a better result if you allow at least 6-12 months to properly plan the sale of your business.

### *2. Put family first*

Take family objectives into account prior to embarking on a path to sale; small differences now can become magnified nearer the point of sale and put the process at risk or lead to family conflict post sale.

### *3. Know your buyer*

The natural buyers of your business will typically pay the highest price; identify who they are and how they assess value so you can prepare your business to maximise valuation and competitive tension on sale.

### *4. Make yourself redundant*

If you are the key person running the business, you need to step away and hire a strong CEO/GM and support team who can prove themselves for at least a year prior to sale. This will give a future buyer comfort the business won't fail without you.

### *5. Pay for some housekeeping*

One of the biggest problems we see is a lack of investment in professionalising the business; sort out financial reporting and accounting, separate the owner's affairs from the business and tidy up legal and operational risks.

### *6. Work your EBIT (Earnings before interest and taxes)*

Every sustainable dollar added to the EBIT figure is worth 'x' times EBIT when you come to sell. Ideally, give yourself two years to realise profit improvement initiatives and demonstrate their sustainability to buyers.

### *7. Leave something for the next person*

Buyers will pay more if there are opportunities for future growth, such as new products, geographic expansion, or new channels; plan and partially implement these opportunities so buyers can believe them, and therefore be willing to pay for them.

### *8. Protect your sales proceeds*

Any proceeds you make from selling your business will be after tax; make sure you have the right tax structure for sale. Also, draw up a wealth strategy for protecting your post-sale proceeds to meet retirement and succession goals.

### *9. Be prepared as timing can be everything*

The M&A market in any given industry can grow hot and cold very quickly, and have a large bearing on valuation. Get your business in a sale-ready condition as early as possible so you can respond quickly to changes in the market.

### *10. Above all, do your homework*

You only get one shot at selling your business, so engage the help of professionals when required. Remember, selling your business is very different to running your business.

## *Kick start your planning now*

Owners can ask themselves the following important questions to start to prepare an exit road map which fits with their own personal, family and business circumstances.

*What are your long term ownership/wealth objectives?*

*How much is enough (to cover retirement, family, lifestyle needs)?*

*Have you considered how your purpose, personal goals, and family relationships will change after you exit?*

*What is the value of your business to a buyer now, and what could the value be when you plan to exit? Would different buyers value your business differently? What factors can enhance or diminish value?*

*Can you respond quickly to a change in business or personal circumstances in order to effectively exit your business at short notice?*

# You need to plan for successful succession

*Family businesses have a unique ability to plan for the long term and set their own course.*

What they don't have is a great track record in passing the baton from one generation to the next. Many failures are due to poor succession planning. Our latest family business survey shows that while more than one third (38 per cent) of family businesses want to hand over the reins to the next generation, more than 80 per cent don't have a plan for how to do it.

## *Succession planning – more than just a document*

Governance, estate planning and financial matters all form part of succession planning. However, to ensure that they are living, purposeful documents, our experience shows that these frameworks or processes must be supported by regular and effective communication between family members and appropriate training and education for the family to provide the best chance of continuity and harmony.

The family needs to focus as much time on family issues and family discussions as it does on its business issues. It is essential to build a family's 'pyramid' from the bottom up, with the foundation or base requiring the family to reach consensus on their shared vision, values and purpose (who they are, what they stand for and what the purpose of the business is) through facilitated discussions. Once agreed, this base then becomes the family's guideposts for decision making and strengthening relationships and family culture. And ultimately, the shared vision, values and purpose should be enshrined in the constitution and used to guide the development of other governance structures to guide the family for the future.

An Australian succession success story, Salta Properties - one of the country's largest property development businesses - made the decision to succeed early on, transitioning management of the $4 billion business from father to son.

Managing Director Sam Tarascio, who took over management from his father (also Sam), admits that despite facing a number of challenges in navigating succession, the influence of good mentors and a supportive network ensured success.

Sam also credits the longevity of Salta Properties to the strong work ethic and mutual respect of its family members, as well as the implementation of formal structures, such as a Family Board and Business Board, which plays an important role in setting clear goals and objectives for the family and the business.

Based on our research, we consider there are five key elements that underpin the family's overall health and ability to meet the challenge of succession.

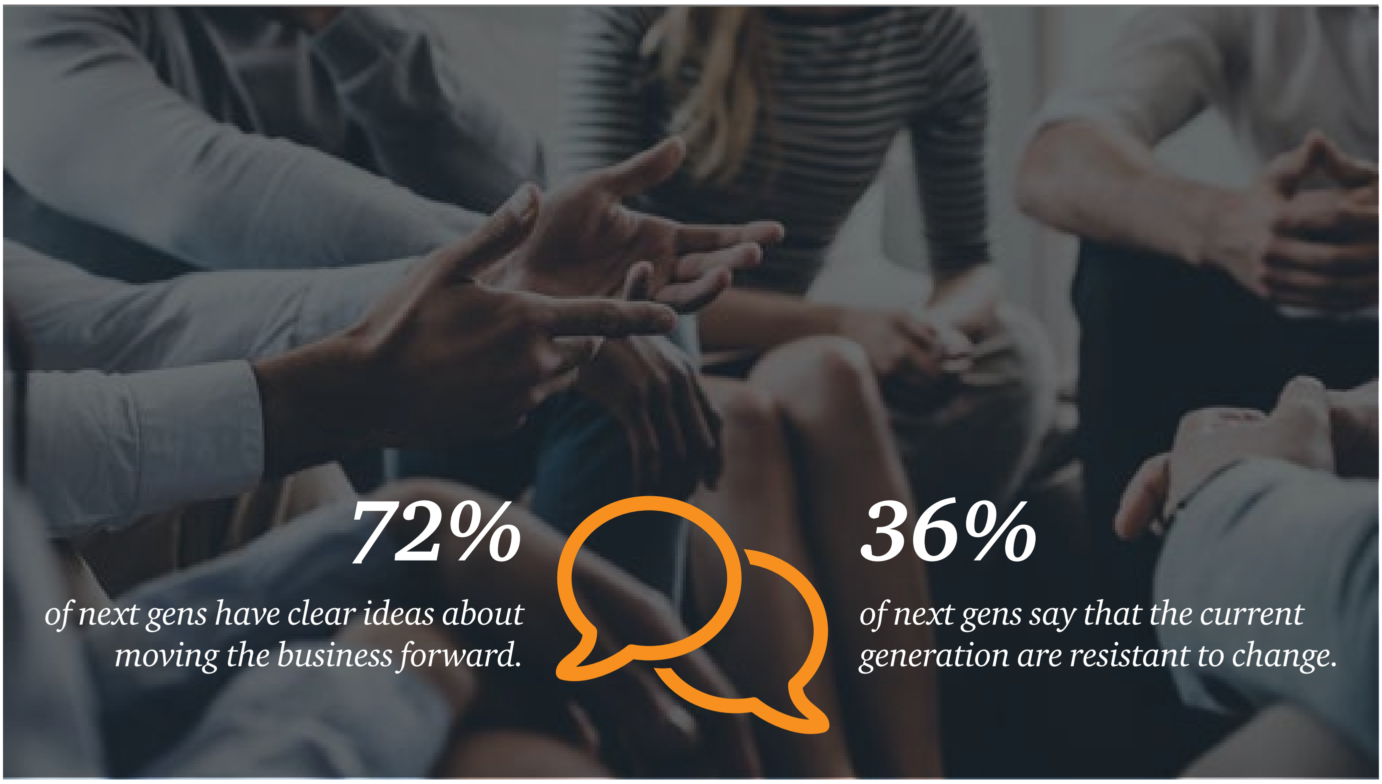
These indicators help show where the overall health, values and vision of the family are at, and how they are aligned. They are not only a barometer of future business success, but also of personal growth and family life.

> *"You need to assess the health of the family with the same depth and rigour as you assess the health of the business – look at what's working and what isn't. Some of it is about family governance, but it's also about softer issues like the way people behave with each other, and the respect – or lack of it – between family members."*
>
> David Smorgon OAM

### *Successful succession - five key indicators:*

1. *Regular family meetings with open communication and dialogue between family members.*
2. *Deep understanding and appreciation of the goals and aspirations of each family member.*
3. *A strategic plan for success beyond the short and medium term, and a long term view on the future of both the company and the family.*
4. *A shared understanding of the family vision and values, and how the family vision and values align with the family business vision and values.*
5. *An appreciation of the responsibilities and roles that come with the family business, including the issue of legacy.*

The reality is that few families take the time to have such challenging and broad reaching discussions, as they can bring up sensitive issues. However, it's worth taking the time to have a considered, formal approach to such conversations, to sure up the family's chances of future success.




## *Listen to the next generation*

Successful transitions also require the next generation of leaders to be ready, willing and able to run a family business and steer it towards growth.

Encouragingly, next gens say they are up to the task. Our recent Next Generation survey found they're confident, well-prepared for senior roles, and have ambitions to grow. And more than seven in ten have clear ideas about how to take the business forward.

Jane Luxford, second generation Manager at The Village Glen Australia, knows all too well the challenges of stepping into a leadership role within the family business at a young age.

"It's been the most challenging, rewarding thing I've ever done in my life and has brought me opportunities that I never thought I would have. It's pushed me and challenged me in ways that I never thought I would be, and I've done things that I never thought I would be capable of doing."

But there are lots of things that the current generation can do to make sure next gens feel involved–and become involved–in the direction of the family business.

One is to give next gens the freedom to make mistakes; another is to give them responsibility early. It also helps to have properly demarcated roles, clarity around strategy and well defined lines of reporting. But perhaps the most important task is to create a sense of family unity and a culture of trust and respect within the business. The most successful next gens we speak to say they feel that both family and non-family members are willing them to succeed, not waiting for them to fail.

Unfortunately, one-quarter of next gens find it difficult to get themselves heard by the current generation of leaders. And more than one-third say that the current generation of leaders is resistant to change in the business. Yet next gens are not sitting on their hands. An overwhelming majority (84 per cent) have taken active steps to put their ideas into practice, despite the reluctance of older family members.

> *Go and work in different industries or companies to gain skills and experience that you can bring back to your business and introduce with energy."*

A next gen from our survey

## *Tips for next gens: 5 skills to get your ideas implemented*

1. *Build credibility*

   *You can't simply assume credibility because you're a next gen sharing the family name. One of the best ways to build credibility is by honing your business skills outside the family business. You can then demonstrate your value by bringing these experiences back into the family business.*

2. *Apply 'two-way' listening*

   *It's important to acknowledge the experience of the current generation of leaders and listen to their perspectives, concerns and ideas. The current generation has a lot to learn from you too, but the communication will flow easier when both sides are open and receptive.*

3. *Have a clear, evidenced-based plan*

   *Often, when next generation ideas are adopted, it's because they've been able to show how it's worked before. This can be through a pilot project or by preparing a business case based on market research. Either way, you need a clear plan and solid evidence to support your ideas.*

4. *Develop communication skills*

   *Personalities and relationships play a key role in family businesses full stop, and this includes getting next gen ideas accepted. Invest in understanding the dynamics of your family and use your communication skills to help you better negotiate with them.*

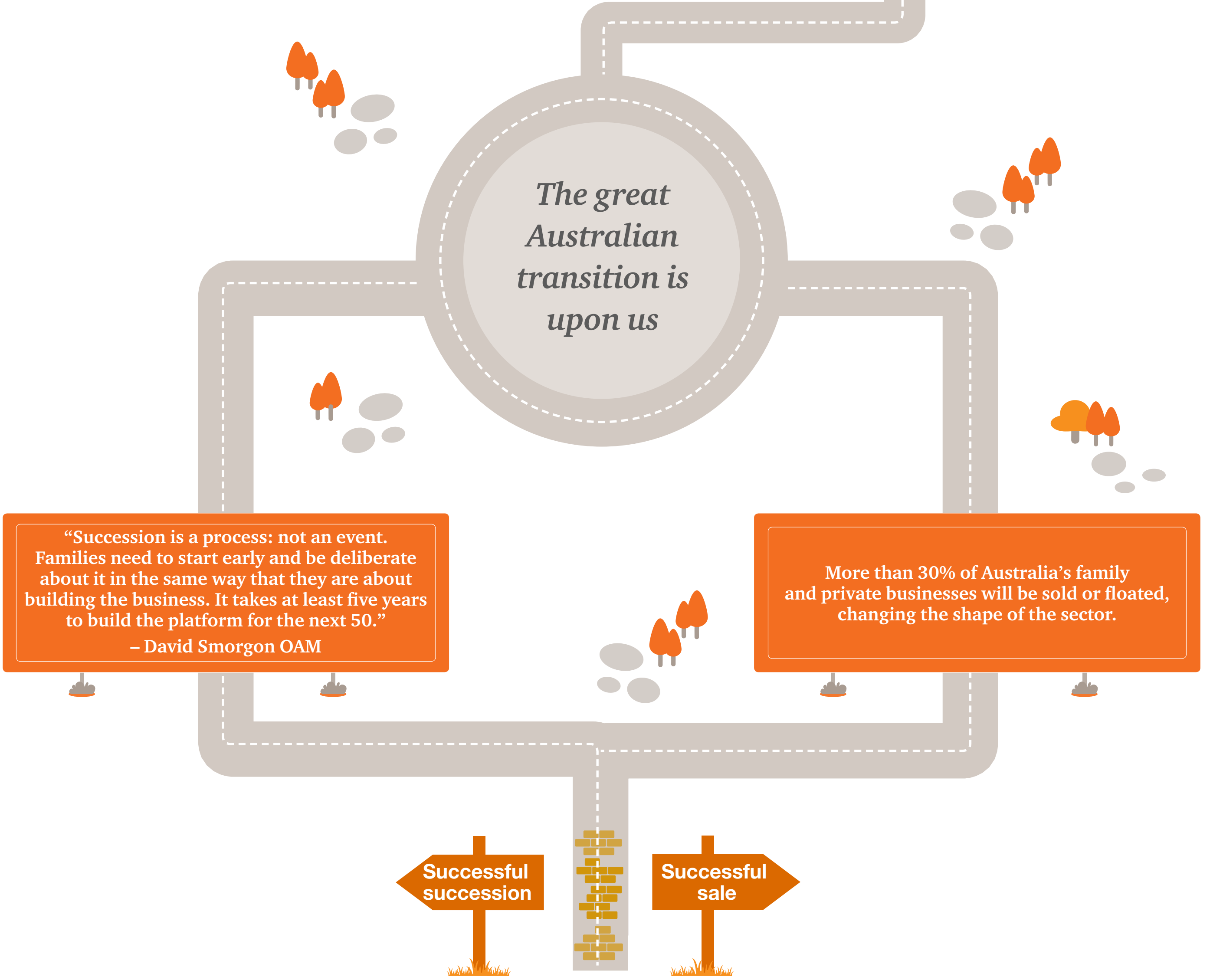
5. *Have patience and persistence*

   *Be prepared to play the long game. Many next gens who have succeeded say it was important to be patient and not give up. Don't storm in and demand change. Rather, work hard to convince key stakeholders.*

> *Place yourself in the current generation's shoes and understand their angle. No does not mean no, it means try again."*

A next gen from our survey

# Australian businesses making the decision




*Elements that underpin the health of the family and successful succession:*

1. Regular family meetings with open communication.
2. Understanding of the goals and aspirations of each family member.
3. Long term view on the future of the business and the family.
4. Shared understanding of the family and business vision and values.
5. Appreciation of the roles and responsibilities that come with the family business.

*With 350,000 businesses changing hands or leadership in the next five years, preparation is the key to success. Plan for the long term.*

1. Have a clear idea of your business values.
2. Understand relevant policy and legislation.
3. Keep family and owners informed.
4. Agree on your goals up front.

# *Let's continue the conversation*

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