

Family Business News



A newsletter for the family business sector

“Genuine leadership comes from the quality of your vision and your ability to spark others to extraordinary performance.”

– Jack Welch, Former General Electric chairman & CEO.

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Reviewing workforce requirements in difficult economic times

Alan Anderson, Executive Director, Performance Improvement Consulting, BDO Kendalls (QLD)

The global financial crisis has impacted a number of work forces. A recent client opinion poll regarding the crisis assisted in identifying strategies to help “rightsized” family businesses.

The opinion poll results were announced recently at a BDO Kendalls’ seminar. The poll was hardly surprising with some of the results including:

- over 60% of respondents (from across a wide range of industries and business size) indicate the economic situation has had a ‘Very Significant’ or ‘Significant’ negative effect on their organisation;
- 30% expect a decrease in the size of the workforce by 30 June 2009;
- 44% expect no change; and
- 13% expect increase in size of workforce.

Top 5 actions *already taken* to respond to the economic situation:

- reduced operating costs (91% of respondents);
- reviewed the strategic plan (74%);
- reviewed workforce structure (65%);
- increased productivity (65%); and
- reviewed the finance function and cash flow processes (61%).

Top 6 actions to be taken by 30 June 2009:

- introducing initiatives to increase individual and team productivity (35%);
- up-skilling or cross-training staff (30%);
- introducing new products & services to meet changing customer demands (25%);
- streamlining operational processes (22%);

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- hiring new talent (22%); and
- increasing productivity (22%).

The open-ended responses to questions about people and resources however, did contain some surprises. For many businesses the hot people issue is still attracting good staff and retaining the better employees. Other people issues were related more to the effects of shedding staff such as ensuring the 'survivors' are motivated, confident, productive, efficient, are cross trained to provide greater flexibility to fill gaps and understand that they will have to work smarter and harder.

A recent Hays Group survey in the US identified the top worries for employees as fear of the unknown, being made redundant, having their salaries reduced or frozen, cost of living and inflation. These types of concerns could impact negatively on employee productivity if not handled appropriately.

A structured approach to prepare for rightsizing

In the current economic climate there is much uncertainty about the future which makes it difficult to plan into the medium or longer-term with full confidence. Therefore, it is important to understand what is most likely to happen in your marketplace so that your short-term plans are still based on achieving your longer-term goals while taking into account the need to respond to the changed economic conditions. These insights will enable you to have proactive control over the running of your business, rather than 'flying blind'.

To implement this approach we suggest the following actions:

- research your marketplace's future (your industry association should be able to help with this);
- develop three scenarios for your business based on your research;
- review your strategic plan against the three scenarios and highlight gaps; and
- develop at least three contingency action plans based on responding to action alert 'triggers' such as a decline in customer count, sales per customer and cash flow.

Consider implications for:

- financials;
- customers & markets;
- processes & systems;
- people & resourcing; and
- the family.

Within each contingency plan develop strategies covering:

- organisational design;
- performance & productivity measures;
- how to manage the change; and
- opportunities.

Involving your staff and key stakeholders

- Be clear about the problem you are trying to solve.
- Open & honest COMMUNICATION is the key – develop and implement a communication strategy to keep staff informed and to build trust.
- Ask staff for their best ideas about raising productivity, reducing costs and working smarter – after all, they have a vested interest in retaining their jobs.
- Provide as much certainty about the future as possible without raising expectations.
- Position the possibility of redundancies once that is a likely scenario.

We know from the lessons of history that we will come out of this economic difficulty at some point in the future. At the point of recovery, businesses will need to have well trained, highly motivated and loyal employees. Given the recent difficulty many businesses reported in attracting and retaining good staff, it makes sense to explore all the alternatives to redundancies, which include:

- hiring freezes;
- cut temporary staff;
- reduce or eliminate perks;
- salary freezes, salary cuts, delay salary increases;
- eliminate overtime;
- redeployment of workers;
- voluntary retirements;
- mandatory holiday shutdown;
- eliminate bonuses;
- reductions in work hours – e.g. 4 day workweek;
- work sharing;
- move to smaller office space;
- rescind hiring offers;
- bring outsourced work in-house;
- cancellation of business trips; and
- delay office/factory expansions.

Some of the above might raise legal issues, so take all necessary advice.

Legal points if redundancies are necessary

At the recent BDO Kendalls' seminar, Aaron Anderson from Deacons Lawyers made the following comments concerning redundancies.

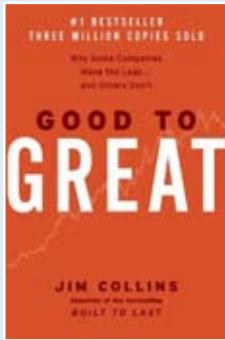
Understand that redundancy occurs when an employer decides that the job an employee has been doing is no longer needed i.e.; it is the position, not the person which is redundant. Reasons for redundancy include technological changes; restructuring of the workplace; an employer's inability to pay employees; and the sale of a business, where employees are not kept on by the new owners. You should make positions redundant based on a genuine operational need to effect change. In deciding which positions to make redundant, use a selection process which is:

- fact based;
- incorporates objective data (where possible);
- uses non-discriminatory selection criteria; and
- complies with award/agreement requirements.

Recommended Family Business reading

Good to Great by Jim Collins

This book was based on a five year research project examining 28 companies and looking at how a good company can become a great company. How can good, mediocre and even bad companies achieve enduring greatness? Why do some companies make the leap from good to great and others don't?



The research identifies companies that made the leap from good to great and had sustained their results over 15 years. There were many common traits challenging conventional beliefs of corporate

success, but the key findings revolved around; leadership, culture of discipline, thinking differently about technology and not making radical changes and restructurings. These traits are often attributed to visionary, long term thinking family businesses.

Related books



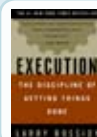
Good to Great and the Social Sectors: A Monograph to Accompany Good to Great

– Jim Collins



Built to Last: Successful Habits of Visionary Companies

– Jim Collins



Execution: The Discipline of Getting Things Done

– Larry Bossidy



First, Break All the Rules: What the World's Greatest Managers Do Differently

– Marcus Buckingham



The Five Dysfunctions of a Team: A Leadership Fable

– Patrick M. Lencioni

Handling redundancies for award and agreement employees in particular, requires business owners to check procedures prior to taking any action. Typically business owners will be required to consult with and/or notify employees, there will be severance entitlements and potential penalties for failing to follow processes set out in any relevant industrial instruments.

The Fair Work Bill 2008 introduces changes to the current regime and provides that an employee will have been unfairly dismissed where the dismissal was not a case of genuine redundancy. This provides for a narrower test than the current exemption and is likely to commence on 1 July 2009. The Fair Work Bill 2008 also provides for a new entitlement to redundancy pay for all employees (with some exceptions) and is likely to commence on 1 January 2010.

Managing redundancies

In managing the process of rightsizing and dealing with redundancies, ensure that your approach is strategic and that you have covered all contingencies. Understand and follow your contractual/legal obligations.

Set a positive tone by communicating regularly and involving staff in helping you to deal with the issues. Throughout the process, treat all employees with dignity and respect so that all feel positive about the business. Assist those who leave by using an outplacement

service which can provide them with counselling and assistance with their resume and job search.

Communicate with and reassure those who stay, in particular look after your 'stars'. Empower and train your management team to manage the change/transition. After rightsizing, outline a new business strategy to provide certainty, direction and focus for the 'survivors', with tough but realistic performance goals, measures and regular review of outcomes.

For further information email alan.anderson@bdo.com.au

Article summary

- Employers continue to face the challenge of attracting good staff and retaining better employees.
- Initiatives implemented to increase individual and team productivity include upskilling and cross training staff.
- Development of communication strategy to keep staff informed and build trust.
- Providing certainty as much as possible without raising expectations.
- Empowering and training management teams to manage change.

Strategic change in the current economic climate

David Krause, Associate, Corporate Finance, BDO Kendalls (QLD)

As everyone is well aware, the economic environment has changed drastically over the past year. It has certainly turned the credit market and general business confidence upside down. Property and Business sales have slowed and where a sale has been necessary, the price is usually significantly reduced. Despite this, one of the fundamental challenges facing Australia (and the rest of the world) has not changed, that being the ageing of the population and the transfer of ownership to the next generation.

This challenge places those in the midst of succession planning in an unenviable position. How do you realise value built up from the business over your lifetime? There is no simple answer to this question; however there may be strategies to assist those in this situation.

Strategies to assist

For those who have made the decision to sell their business, a desired strategy may be a complete divestment of the business. However, buyers are nervous at the present time so this outcome is not always easy to achieve. This means that vendors need to think “outside the square” to help alleviate the concerns of buyers. Some of the strategies we have employed recently that have worked quite well for vendors and buyers are:

- vendors taking a convertible note from the buyer as part consideration;
- merging with a compatible company with a put and call option to sell at a later date; and
- recruiting new management with an option or obligation to acquire an equity interest in the business.

Each strategy has its benefits and shortcomings; however, the aim of employing any of the above is to realise the benefit of the asset for a reasonable value.

Convertible Note

Under this approach, the vendor receives an upfront payment, usually from bank finance and the purchasers' equity, for a significant proportion of the value of the consideration and takes a convertible note from the buyer for the balance of the consideration. This effectively means the vendor is providing additional equity for the buyer to obtain the bank finance.

The convertible note can be structured in a number of different ways and will depend on the specific circumstances of the transaction. A convertible note may provide the option to redeem the note in cash or convert to equity at certain events such as a trade sale or initial public offering ('IPO'). This approach may assist the buyer to gain confidence in the business (as the vendor remains financially involved in the business). The approach may also assist to maximise the sale price.

Merger

While there are many benefits and shortcomings of a merger, by agreeing to a friendly merge with a competitor, coupled with an option or obligation to sell, the opportunity to exit the business may be the most significant benefit of the merger. This method may allow the vendor to gradually exit the business and provides less risk for the buyer. For example, it is important to also consider the time period over which the option can be exercised and the methodology to determine the price of the exercise. If a longer option period can be negotiated, the economy may improve in that time and ultimately result in a higher price, depending on the structure of the option.

To complete a merger, a contract will need to be negotiated to include a shareholders agreement. This document will set the ground rules for the way in which the merged business will be managed.

Partial sell down to new management

This approach is similar to a management buy in, except a full divestment is not occurring immediately. This style of transaction may be useful where a 'hands on' owner and operator is looking to retire and has found it difficult to divest 100% interest in the business.

To execute this approach, the vendor will recruit appropriately skilled and compatible manager/s to run the business and hands over management duties of the business over time. New management is recruited for two reasons:

1. they have the skills to run the business; and
2. they have a desire to operate and own their own business.

Often an agreed amount of equity is purchased either upfront or after a probationary period. One outcome of this approach is that it often releases capital owned by the vendor that is locked up in the business, provides the vendor value for their asset, and potentially improves their lifestyle by not having the pressure of having full responsibility to operate the business.

In either option explored above, the effect of taxation, including small business capital gains tax incentives, need to be addressed. Each option by itself will trigger a capital gain. The amount of tax payable will depend upon the circumstances of the individual vendor, especially when coupled with CGT provisions which provide a reduction by accessing:

- 15 year exemption upon sale;
- retirement exemption;
- asset roll-over; and
- 50% active asset rollover.

By accessing one, or a combination, the gain made can be significantly reduced or deferred. Advice should be sought from a recognised tax adviser before proceeding with any option which takes into account the full position of the vendor.

The current state of the economic environment may prove challenging for those parties wishing to continue with their succession planning in the short term. However, if vendors (and their advisors) think outside the square, a positive outcome is achievable. Strategies which include those mentioned above may assist to achieve a fair and reasonable price for an important asset which may take years (if not a lifetime) to develop.

For further information email david.krause@bdo.com.au

Article summary

- Transfer of business ownership to the next generation in the current economic climate can be challenging.
- There are three alternative strategies for gaining an enhanced value for your business.
 - 1) Vendors taking a convertible note from buyer receiving an upfront payment usually from bank to finance significant portion of the value and takes convertible note from buyer for the balance.
 - 2) Merging with compatible company and considering selling at a later stage.
 - 3) Recruiting new management with an option to acquire an equity interest in the business.

Preparing successors for leadership

Lyall Bear, Director and Family Business Consultant, Private & Entrepreneurial Clients, BDO Kendalls (WA)

Succession should involve a well-planned partnership with the next generation, and founders can assist the process by taking responsibility, particularly in the following areas:

- ensuring their children receive a sound, broadly based education;
- that the children are well nurtured and develop self-esteem;
- that they learn about money, business and investment;
- that they have, where possible, extended outside work experience before joining the family business; and
- once they do join, that there is an in-house training program for them that is both relevant, worthwhile and appropriate in relation to the career development strategy set out in the written succession plan.

Wider business experience. Learning how other firms work will almost certainly benefit succession candidates throughout their business careers. The most successful non-first generation managers of family firms have often spent much of their early working lives outside the family business. Succeeding at something, independently and away from the family nest, helps to build self-esteem and confidence.

Credibility with non-family employees. A founder's son or daughter who leaves school or university and straight away becomes deputy MD of the family business is likely to be the cause of bitter resentment among non-family employees.

Entry to the business should address the following key issues:

- **Define their role.** Conflict over children's functions in the business can be a major source of tension. Consider separating responsibilities, either on the basis of operational criteria (e.g. production and marketing) or, if the business lends itself to it, geographically.
- **Set objectives and provide feedback.** Employees, including children, need to know what is expected in their jobs. They also need regular feedback about their performance, including recognition for achievements and constructive advice on aspects of their work that need improving.
- **Pay children the going rate.** Experience has shown that the fairest and healthiest remuneration system is to pay family members the market rate for their jobs as though they were working for another firm. Other less objective systems generally lead to resentment and conflict.
- **Choose your successor as soon as you can.** Once the choice has been made, leadership and control of the business should be transferred in a step-by-step process that allows for smooth adoption of new roles and responsibilities (by the successor and the founder) and that minimises pain and disruption.
- **Establish a target date for your retirement.** This should be far enough ahead so that your successor and everyone else can plan and prepare for it. Once you've set a definite date, stick to it.

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BDO Kendalls Family Business Profile

Bruce Hatcher

Bruce Hatcher is an accredited Family Business Adviser who leads the BDO National Family Business Consultancy practice. He has worked with a wide range of clients covering most industry sectors, and he has a thorough knowledge and understanding of the various factors that affect individual business performance. Bruce provides broad based consulting advice on Family Owned Businesses.



He consults to and serves on the boards of several private and/or family owned businesses and is Chairman of the Queensland practice. Bruce has international experience and has worked with a number of prominent industries including motor, building and tourism.

The areas in which he has particular interest include Corporate Governance, Family Councils, Succession Planning, Taxation Structures and Restructuring. Bruce regularly speaks on Family Business topics and has written many articles on a wide range of Family Business issues.

“The problem is, as advisers, we get most of our work in a crisis.”



Family Business Australia (FBA) has announced the first of its Accredited Adviser Members. BDO Kendalls have FBA Accredited Advisers who provide a national service consulting to family businesses. Our advisers / consultants are experienced and appreciate the complexities of the business and the needs of the family. This experience is underpinned by the BDO process, a best practice methodology for family businesses.

BDO Kendalls' Family Business team is here to help, so please contact us at your nearest office or visit our website www.bdo.com.au. We can then send you further information or arrange an appointment at a convenient time to discuss how we can help you in managing your family business issues more effectively.

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Family business owners must be honest in assessing the capacity of their son or daughter to become a business leader. If a child lacks that capacity, the owner must face up to this reality because, like so many other family business problems, brushing it under the carpet will only make it worse.

Over-promoting offspring does them (and the firm) no favours at all. As well as damaging the business, putting a child into a high-powered job that is beyond their risks causing alienation among family members and destabilising the child's career, and possibly even their whole life. Consider the possibility of bringing in an outsider to run the company – children who still want to be involved may well fit in at a lower level.

This of course represents the worst case scenario. Reality is likely to be more marginal, with capacity for the job more of a touch and go affair. Also, it is possible that although someone may not be up to the job at the moment, they could still grow into it in the future. This situation, therefore, involves striking a balance between, on the one hand, cutting the offspring off from opportunity and on the other, giving him or her at least a chance to make the grade.

Third party advice should be sought in helping a son or daughter identify priorities and objectives for their future careers, and for owners in objectively assessing the business acumen of their children.

Quite often it becomes clear that a child will grow into the top job in time, and a useful solution here is to employ a caretaker MD until a transition within the family can take place.

Founders today are less likely to count on their children as automatic successors as they were in the past. There is growing concern about the long-term welfare of the business in circumstances where successors have grown up believing that they will inherit the shares as a matter of right, rather than having to demonstrate tangibly their level of commitment. One solution to this concern involves the children being given some shares, but only on condition that they purchase the balance on their eventual holding. The need to find, say, \$250,000 for 35 per cent of the company as a condition of receiving the remaining 65 per cent free, could become an increasingly common requirement that will obviously help children to decide just how serious their commitment and desire to join the firm really is.

For further information email lyall.bear@bdo.com.au

Article summary

When children enter a family business:

- Define their roles.
- Set objectives and provide feedback.
- Pay the going rate.
- Choose your successor.
- Establish a target date for your retirement.

Letting go: Relinquishing control of the family business

Lyall Bear, Director and Family Business Consultant, Private & Entrepreneurial Clients, BDO Kendalls (WA)

Succession problems are usually characterised as the parental generation's struggle to let go of authority, responsibility and control – passing the baton to the next generation. And certainly, those problems can be dauntingly real and frightening to almost all business owning parents.

We find that a parent's greatest fear is loss of power in the family. What happens if a family is in conflict or a family member is in need? Parents often feel that keeping control of the business and its purse strings provides extra strength in addressing potential family problems.

But we believe succession – and “letting go” in particular – is a two-way street. One family business successor's insights help to clarify the lesson.

“I finally got it! It was my expectations that made the power struggle so painful for me,” he explained. “My parents rightly were upset by my expectations of them. And the longer I held on to those expectations, the more they fought letting go.”

He then describes several expectations that we found familiar and widespread among next generation members of business owning families. They include:

- **Entitlement** – the expectation that the next generation deserves what the parents have.
- **Fairness** – the expectation that parents should treat each sibling equally.
- **Perfection** – the expectation that the parents should take all the initiative and provide all the wisdom in letting go.
- **Responsibility** – the expectation that parents should straighten out conflicts among the offspring.

Parents who have these expectations of themselves or who accept them from their children inevitably face great frustration. Next generation members who cling to these expectations retard their own growth and development.

Even as they complain of inadequate progress toward succession, next generation actions can subvert the process. Each time one sibling complains to parents about another, succession is slowed. Every time siblings need parental help to solve problems among themselves, they slow succession. Every time a member of the next generation asks parents for financial resources to help support lifestyle or personal need, succession slows.

Who can “Let Go?”

Parents “let go” best when they are economically secure and believe that stewardship creates a duty that they pass the business to future generations.

Children “let go” best when they are competent, self-reliant, and eager to assume leadership responsibility.

Part of succession – and personal maturity – is “letting go” of the expectations one has towards one's parents.

When successors hold four beliefs, we find that they are able to “let go” of problematic expectations. Then they can more comfortably negotiate the inevitable trials of generational transition. The four beliefs are:

- they appreciate that their parents are not perfect;
- they accept parents for who they are, with respect, and love;
- they understand that life sometimes isn't fair; and
- they assume personal responsibility of their own life, security, and identity.

We are not sure which comes first, but we find that parents' ability to let go of power correlates with the next generation's ability to let go of emotional expectations of their parents.

As one successor concludes, “when I assume personal responsibility for who I am and for my own success, my parents can't wait to support me. They seem to draw on my strength. It helps them.”

For further information email lyall.bear@bdo.com.au

Article summary

- Parents greatest fear is loss of power in the family.
- Part of succession and personal maturity is “letting go” of the expectations one has towards one's parents.
- Parents “let go” when they are economically secure and have a sense of duty to pass the business to future generations.
- Children “let go” when they are competent, self reliant and eager to assume leadership responsibility.

Q&A

Cash flows

Question

At present I am a second-generation manager of our family business with every intention of becoming the next generation owner of the business. We have a strong asset base but our cash flow is tight, will that impact on our ability to change our ownership structure?

Answer

Cash is a finite resource. It is like fresh air to humans –without fresh air a human will die in approximately eight minutes. For a business, it is similar. A business starved of cash will struggle. History is littered with stories of companies that have been asset rich, but who have failed because they have run out of available cash. For a business, cash flow will always be a critical issue.

Many family controlled companies that have been operating for many years have accumulated substantial assets but find that cash flow is limited. When the assets are used in the business, there is often a reluctance to sell those assets. Consequently, this restricts the options available to source funds.

A company needs to treat shareholders as a source of capital funding on which a return is to be paid. This can only be achieved by the payment of dividends, and usually these need to be paid in cash. Where the shareholder has borrowed to fund the purchase of their shares, the payment of a cash dividend is often essential to allow the shareholder to meet their repayment commitments.

Cash flow has to be measured and managed. Cash flow is two parts – inflows and outflows. Chasing debtors to collect the cash sooner, reducing stock on hand, selling surplus assets, by extending the terms of creditors, and new loans, can improve inflows.

Purchase of fixed assets, increases in stock levels and increases in trade debtors and retirement of debt all consume cash.

Just as a company needs to set a budget for profit result so too it needs to prepare a cash flow budget. This budget needs to be reviewed and compared to actual on a constant basis. The object of the cash flow budget is to identify periods when cash flow will be restricted so that action can be taken to ensure the continued operation when cash flow is restricted.

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Diary dates

FBA State Conference and Awards:

03 April – NSW/ACT
30 April – WA
01 May – QLD
20 May – SA
28 May – VIC/TAS

FBA National Conference and Awards:

13-15 August – Darwin

Please contact your State representative for more information on 1300 138 991

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We want to hear from you

Your feedback is important to us. If there are any topics that you would like addressed in Family Business News, please send your request through to marina.skinner@bdo.com.au

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