WEALTH IN TRANSITION

Family offices in plain view
Research into the Family Office Market in Australia, Hong Kong, New Zealand and Singapore

October 2021

KPMG

THE TABLE CLUB

Welcome

We are delighted to welcome you to this joint research report by KPMG Australia and The Table Club (TTC), "Wealth in Transition" detailing our findings from our survey in late 2020 to early 2021.

The survey comprised of quantitative and qualitative engagements with over 80 Family Offices and UHNWs across Australia, Asia, and New Zealand.

Our aim was to learn more about the evolution of Family Offices in the Region, and to understand how participants were managing macro-challenges including:

- How they are steering generational changes in the Family Office.
- How they structure their investment strategies and what drives those decisions.
- How have they navigated the impact of COVID-19.
- Their views on Environmental, Social and Governance (ESG) challenges when it comes to investment.
- How they are operationalising the family office and role of technology in doing so.

Of key interest was to understand how generational change in the Family Office was influencing their approach to wealth management, as well as the 'purpose and mission' of the Family Office.

Our research was supported by a Steering Committee of Family Office, principals, executives and finance professionals from different generations, all listed later in this report.

The committee, including our Chair, David Murray AO, the inaugural Chairman of the Australian Future Fund, provided insight and interpretations into the responses from their experiences. This helped to turn the data into powerful knowledge, and we are grateful for their participation.

The generosity of the responses from participants provided a rich source of knowledge that has brought into plain view the growing importance and influence of family offices. We thank them for their openness and appreciated their willingness to contribute and share the benefit of their own experience. We hope that through this Report they will all learn a little more from each other.

We would also like to thank our sponsors, Invesco, Minter Ellison, LAVO and Providence Asset Group for their contributions to the study. Additionally, we had wonderful insights from our Academic Partners, University of Technology Sydney, UTS, and Wade Institute, University of Melbourne. Lastly, we thank The Future Fund for their inclusion as a case study on long term investment behaviour, as an ideal model portfolio for family office investors.

We hope that you enjoy reading this report and look forward to continuing our Research into Family Offices as they continue to emerge, mature and evolve across generations.

ROBYN LANGSFORD
Partner in Charge, Family Business and Private Clients, KPMG Australia

JAMES BURKITT
Founder, The Table Club

Contents

Foreword

It is with pleasure that we bring you this Report on Wealth in Transition within the Family Office sector. I am delighted to have Chaired the Steering Committee and have enjoyed the interaction with the teams from KPMG and The Table Club, as well as the contributions from our other Steering Committee members.

The Next Gens Sub – Committee's views, in particular, on the responsibility of taking the "baton" from the previous generation, have been very constructive in how we have explored the topic of our report, "Wealth in Transition".

The longevity and success of any Family Office is agreement of strategy and philosophy by the family members. I found this concept was also the most important factor for the Future Fund during its' formation and as an ongoing check point. The development of an investment philosophy that sets the direction for translating the goals and parameters into investment policies and strategies, was fundamental. The Guardians of the Future Fund found the experience of similar funds globally, was that success is dependent upon having a clear purpose and mandate; effective governance by a Board and high quality management. I see similarities with the needs of family offices, and this report helps to explore a number of those needs.

"Mission and purpose matter to the next-generation", we found that a renewal of the mission was key to achieving their goals. Each generation can be part of that process. Rather than accumulating money for its own sake, the family members wanted a more altruistic reason for the family office. This has translated to the concept of conscious capitalism. Within these thematic, the report examines the growing interest in ESG and Impact investing.

I hope you enjoy this report and that it assists in how you build the right framework for the future management of your family's capital.

DAVID MURRAY AO

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The secret to success for our family is scale, and keeping the family money together.

FIFTH GENERATION FAMILY MEMBER

Introduction

Wealth, well managed, creates its own momentum. There is something powerful and purposeful in the idea that efforts made today can benefit future generations of a family.

This desire to leave a legacy has encouraged more wealth creators and their successors to manage their wealth as a 'business'. Many are now doing so in the form of a 'Family Office'.

The rise of the Family Office

At the start of this century, the term 'Family Office' was rarely used in Australia, with the exception of Family Office owners and a small number of trusted advisers. Meanwhile, the term had become mainstream in the US, along with the development of associations whose members were the Principals and executives of Family Offices. In Europe, where mystique was associated with the alternative term 'Private Office', the sense of a community was less pronounced. Private Offices were mainly related to the financial centres of London, Paris, Munich and Zurich.

In only two decades, much has changed. Australia has seen the emergence of the term as part of the financial lexicon. Reference to 'Family Office' investment activity in the financial press is now common. This is not a deliberate policy on the part of Family Offices to become more visible, but a result of:

- A rapid increase in the incidence of wealth realisation events post the global financial crisis (GFC) that have increased the number of families thinking about setting up a Family Office
- The growth in professional and financial services firms catering to the needs of independent wholesale private clients, expanding the range of products and services targeting the ultra-high net worth (UHNW) market
- An increase in the importance of private capital in funding economic activity
- The advances in self-managed wealth management enabled by technology, and with it the sophistication to build an independent wealth management infrastructure
- An appreciation of the potential opportunities and threats posed by the ownership of wealth that will outlive its current owners.

Competitive landscape

Along with more prevalence, Family Offices, whether they wish to or not, now compete with institutions as the preferred buyers of private assets. Whereas once those seeking capital would look to work with larger institutions and loftier names of the investment world, there is now a shift in favour of Family Offices. This has become apparent as notable Australian Family Offices are being selected ahead of institutions to underpin investment in new funds and projects.

Whether this phenomenon is due to an increase in the size and sophistication of the Family Offices, a decrease in the reputational value of the institutions, or is part of the 'conscious capital' movement is not clear. However, what is clear is that Family Offices are no longer considered the 'funder of last resort'.

Principal power

Another explanation for the increase in Family Offices winning opportunities, particularly with emerging or growth companies, is the power of the Founder/Principal and their ability to add value beyond the provision of capital such as their experience and insights.

Principals are also increasingly surrounding themselves with top-tier talent to establish leading investment houses, normally in distinct verticals. Family Offices are now attracting talented, skilled staff by offering a higher level of autonomy, flexibility, and the ability to have meaningful impact on investment decision making.

In plain view

Despite the growth of Family Offices and their increases in investment and talent, privacy and discretion remain a priority. In today's world of fast-paced media and global connectivity, the activities of Family Offices are very much 'in plain view'. Despite this, most participants desire to maintain their anonymity and continue to work on being 'under the radar'. They recognise the challenges, including security risks and reputational pressures, that being in the spotlight may bring.

Executive summary

The responses to our Wealth in Transition survey and interviews captured a great diversity of views and relative positions within the Family Office sector. Our respondents were physically dispersed, as well as generationally and philosophically different. While this is positive, it makes attempting to generalise the responses problematic.

However, some stand out findings included:

The Family Office is professionalising

The Family Office is now being recognised as a preferred structure for family wealth management, and seen as a business to be managed like any other.

Mission and purpose matter to the next generation

Next generation family members are increasingly involved in the design of their Family Office with a focus on governance, renewal of mission and purpose, and merging tradition with innovation. They want a reason for the Office to exist beyond accumulating money for its own sake.

Risk management is idiosyncratic

Less than half of Family Offices have 'broad diversification' as a strategy for managing risk, or have formal investment committees. More are appointing independent non-executive directors to their boards.

The wealthy are ready for risk

Family Offices are expecting to increase their exposure to risk assets in the next 12 months and continue to benefit from supportive Australian Government monetary policies.

There is a risk mismatch

Whilst 'risk allocations' may be increasing, 'risk tolerance' may not. There is a likelihood of some misalignment between individual family members as the next generation take over from founders.

COVID-19 has not slowed the Family Office

Family Offices anticipated the shock to asset prices brought on by the initial stages of COVID-19 and were well placed to capture opportunities that arose. Over 30% reported an increase of greater than 10% in the value of their portfolio in the period to December 2020.

Succession stresses are universal

The issue of who will lead and how can be just as complex in the Family Office as in a family enterprise. While it is an issue that cannot be ignored, less than 40% are prepared. Family Office founders are concerned with what the impact of 'dilution' of ownership and control will have on the future of the Family Office. Family Office inheritors are concerned about having clear expectations and understanding what the role will require.

Philanthropy is now strategic

Wealthy families now approach philanthropy in the nature of 'problem solving', through a strategic lens. Rather than giving a 'gift', their aim is to help build capacity and scale for a more significant impact.

Conscious capitalism counts for the next generation

There is an increasing focus on ESG concerns in investment portfolio construction. Impact Investing is also being actively considered by many Family Offices, with education a key area of interest.

Technology is enabling the Family Office to self-serve

While some Family Offices are struggling to understand how technology can increase their back-office efficiencies, others are embracing new software to drive powerful data and analytics for decision making.

Cyber risk is on the rise

As threat actors rise, so do the cyber security risks for Family Office operations, with security incidents increasing locally and globally. While risk management needs to be proactively managed, Family Offices are more reactive and may underestimate the likelihood and impact of risks beyond investment risks.

The Table Club 500

Wealth across Australia

The Table Club (TTC) partnered with KPMG to undertake the Wealth in Transition survey. TTC is a private membership group founded in Australia in 2009, connecting over 1,300 Family Offices/UHNWs across 10 geographies.

It includes some of the world's oldest and largest Family Offices. TTC facilitates networking opportunities, idea generation and co-investment opportunities on a global scale.

TTC generates its own research into the Family Office sector. Some of this information supports this report – including information from the 2016 TTC Private Wealth report[1], as well as their updated 2021 The Table Club 500 (TTC 500) report.

TTC's most recent study focuses on the wealthiest 500 individuals, Single Family Offices (SFOs), and Multi-Family Offices, (MFOs) (organisations that run a number of family's offices). TTC draws on sources with a minimum wealth of $120 million, as this figure is what TTC consider to be required to establish a Family Office. The Table Club 500 (TTC 500) represents total wealth of $631 billion (at June 2021), with member's wealth ranging from $120 million to $31.1 billion.

In line with the data collected during the KPMG Wealth in Transition survey, over 60% of the TTC 500 primarily generated their wealth in the traditional asset classes of Property, Investment, (which includes operational businesses, Private Equity, credit and other asset classes), and Financial Services.

In 2021, TTC added 100 new participants to the TTC 500. Of the new additions, 43 (47%) derived their wealth from technology-related enterprise. However, this may be slightly misleading as, rather than a transition away from traditional industries into technology, there is greater penetration of technology into traditional industries such as AgTech, FinTech and Property.

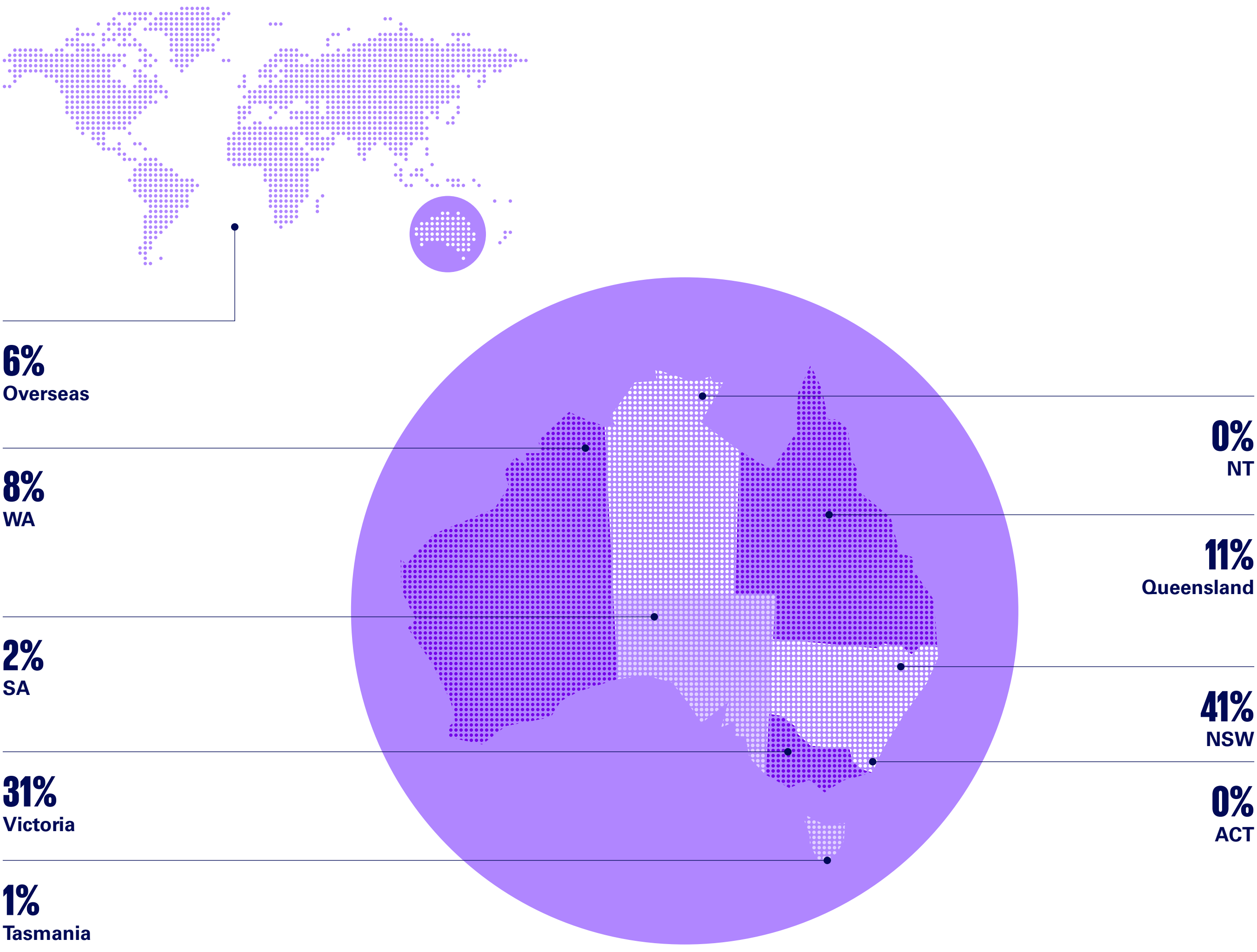
1 KPMG has not separately verified the data nor contributed to the production of The Table Club 2016 report, which is proprietary to The Table Club.

Wealth hot spots

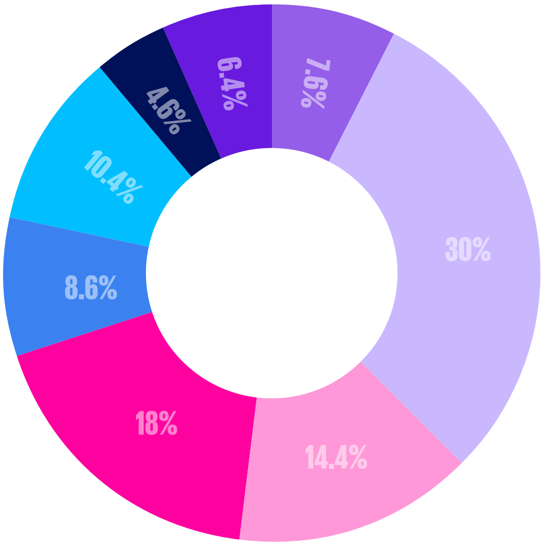
Sydney in New South Wales (NSW) and Melbourne in Victoria remain the centres of wealth in Australia, with over 70% of TTC 500 primarily residing in these locations. Unsurprisingly, the wealth generation in these locations was largely driven by Property and Financial Services. These locations are also home to the vast majority of multi-generational Family Offices, although still wholly 85% of TTC 500 members are primarily represented by the first or second generation.

Queensland and Western Australia registered the third and fourth largest populations of TTC 500 members, with the bulk of wealth generated coming from the resources sector.

Location of TTC 500 members



Industries of TTC 500 member



Agriculture	6.4%
Resources	7.6%
Property construction	30%
Technology	14.4%
Investment	18%
Financial services	8.6%
Other	10.4%
Retail	4.6%

TTC 500 – Average Wealth in Australia by State

TTC 500 residents in NSW and Victoria had a similar mean wealth figure, $1.12 billion and $1.04 billion respectively. While the average NSW TTC 500 member is now worth slightly more than the average Victorian member, this hides a pronounced increase in the number of wealth holders in NSW relative to Victoria.

State	Avg. wealth (AU$Bn)	Avg. annual wealth growth
NSW	$1.12	17%
WA	$2.53	31%
VIC	$1.04	21%
QLD	$0.93	10%
ACT	$2.53	30%
OS*	$1.68	13%
NT	$1.26	16%
TAS	$0.69	6%
SA	$0.68	10%

Since the 2016 TTC Private Wealth report, the average wealth of TTC 500 members in NSW has increased by 17% per annum, while for Victorian members it increased by 21%. It could be presumed that a great deal of this increase is driven by the number of tech unicorns to emerge in both Sydney and Melbourne. Western Australia (WA) led the TTC 500 report in two categories, having the most new additions since the 2016 report, and having the highest average wealth increase over the past five years; outstripping all other states with a growth rate of 31% per annum. WA also had the highest mean wealth figure, at $2.5 billion – skewed by the vast wealth gains of the iron ore miners.

The Australian Capital Territory (ACT) had the second highest average wealth figure; however, this is due to one individual from ACT who makes the list, with their wealth at $2.5 billion, which grew 4% per annum over the past five years.

New billionaires

> *While it may appear that a unicorn is created every minute, claiming a spot in the billionaires' club remains elusive.*

Only 125 (25%) of TTC 500 members had investable wealth estimated to be in excess of $1 billion. A further 105 members (21%), had an estimated wealth between $100 million to $200 million, with the majority of TTC 500 members having wealth between $200 million to $1 billion.

Driven by technology

TTC used to consider $200 million the minimum viable amount of investible wealth required to be able to economically sustain a well-resourced SFO, with those having less than $200 million generally classified as UHNWs. Since then, TTC has revised this figure to $120 million. This is driven by the availability of Fin-Tech solutions, process automation, and the Family Office services economy, which are making it easier to run an efficient Family Office at lower cost. Many of the SFO's in the lower quartile of the TTC 500 draw on these capabilities to operate with institutional efficiency that rivals many of their top quartile peers.

Survey background

In late 2020 and in early 2021, KPMG, in conjunction with TTC, conducted the Wealth in Transition survey. We asked Family Offices from The Table Club network to respond to a series of questions focused on both their current, short-term and longer-term perspectives.

Questions ranged from the impact of COVID-19 through to the risks they had encountered as a consequence of cyber threat activity. We received survey responses and also conducted interviews totalling 80 participants. We would like to thank all participants for their time and information.

Our respondents

Over 75% of respondents were either SFOs or MFOs, with the balance being individuals in control of significant private wealth. Australian Family Office representatives made up 76% of respondents, with 36% based in Sydney, NSW, and 19% in Melbourne, Victoria. Other responses were received from Hong Kong, Singapore, Taiwan, Indonesia and New Zealand.

Illustrating the scale of financial resources available to, and exercised by SFOs, nearly one fifth of respondents reported controlling over $1 billion of financial assets, 20% in excess of $500 million, and 30% over $100 million.

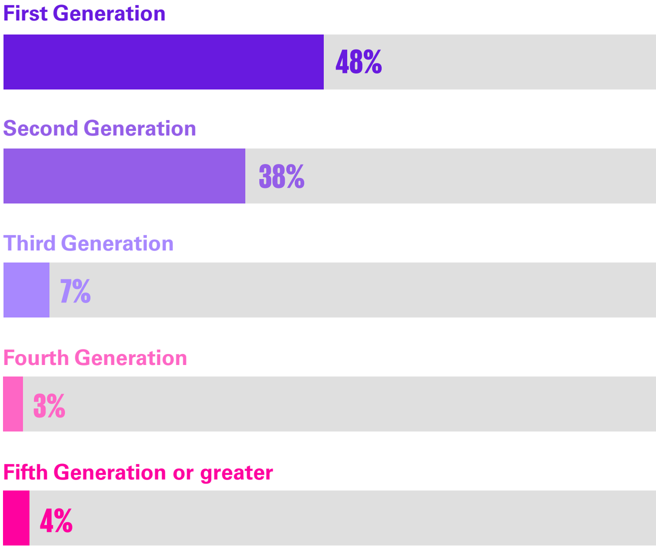
The balance of respondents, approximately 30%, reported being in control of up to $100 million of financial assets, indicating that new technology is reducing the costs of setting up and running a SFO.

In regards to how the various family's' wealth was originally created; the two most significant contributors were Real Estate and Financial Services & Investment. Combined, these sources represented over 50% of the responses. Another 10% reported their wealth was created from Technology investment – a percentage that will surely grow in future.

Less than half the respondents were from the first generation of wealth owners, suggesting that the transition of ownership and control from one generation to the next is underway. However, the responses indicated that there is little uniformity about managing this transition process. This may be due to the relative immaturity of Australia's Family Office sector, where 85% of survey respondents were from generation one or two, or may simply be that every family is different.

Figure 1

Which generation of the family currently manages and controls your wealth?



The first and second generation continue to dominate Family Offices.

The skill will be in maintaining control and ownership through subsequent generations.

Family Office foundations

It is often thought that the Family Office is created due to demands from second generation family members. However, more Family Offices are being set up by the wealth originators, aware of the importance of having structure to support the management and subsequent transmission of wealth.

Proving the point, less than one fifth of respondents were managing their wealth for only one generation (their own presumably), whereas over 30% were supporting three generations or more. In one case, more than four generations were being served by the Family Office.

Over 90% of respondents reported working inside the Family Office or as part of the wealth management process. Of this group, the most common role (37%) was that of the Chief Executive Officer (CEO), with over 40% of respondents being either the Chair or member of the Family Board.

Mission and purpose first

In 2020, the start of the COVID-19 pandemic saw work habits and practices change, potentially permanently. Meanwhile, social movements such as Black Lives Matter and Me Too meant the articulation of society's expectations regarding diversity and inclusion was unambiguous.

Wealth, and what it means to be wealthy, have not been immune from these changes. As society, the economy and financial markets have needed to respond quickly to changes, wealth owners have also recognised the need to rethink their approaches.

Family Offices have increasingly recognised the importance of defining a 'mission and purpose' to underpin the Family Office. This can be a 'reason for existing that motivates the members'.

There are several reasons for this:

- The broader adoption of business processes in the Family Office is leading to enterprise-style practices – such as having a clear purpose.
- Over 70% of respondents want to ensure the longevity of the Family Office to serve the needs of at least two or three generations. If there are already funds to support the next generation, a purpose gives everyone the drive to keep it growing.
- Purpose, once defined, provides a 'North Star' for future generations to follow.
- Events such as the COVID-19 pandemic which highlight the power of wealth to make a difference, are driving 'wealth consciousness' in families and Family Offices.
- Social media is shining a spotlight on the choices made by the world's wealthy, showing that with wealth comes responsibility and scrutiny. Reputations matter and having a 'purpose' helps demonstrate good citizenship.

A shift in purpose

For many years, the mission and purpose of a Family Office was often defined as being to 'preserve wealth'. Rule one was, 'do not lose money', with rules two and three being simply to 'remember rule one'.

However, with the reasons listed above in mind, this is no longer satisfactory. There is benefit of scale in keeping family wealth together in a Family Office, rather than divested amongst family members. Therefore, an underpinning mission and purpose adds to the ability to achieve this. To work, it needs to be identified by the family, stakeholders, managers and employees and considered relevant.

To this point, one next generation family member observed:

> "You cannot understate the importance of storytelling and establishing family values to protect wealth for future generations. What are the family parts of the family business? What does the Family Office provide for family members? All these aspects need to be considered to keep the family harmonious with consistency in their values."

We asked our participants,

How do you view the main purpose of the Family Office?

Over 35% of respondents agreed that it encompassed all four of the following:

Managing family members' wealth (an individualistic focus)

Managing the family's wealth (a collective focus)

Developing the family's philanthropic aspirations

Educating family members

As an accumulation of multiple responses, 'Managing the family's wealth' was still viewed as the most important purpose. However, it is clear that considering the needs of individual family members, and therefore the services that Family Offices should deliver or manage, is now more appreciated.

For many, philanthropy has become an integral purpose to the Family Office, and is also connected to how the family's identity is developed. For some, this focus on philanthropy is the result of a generation of more socially active and environmentally aware family members. This is explored in more detail later in this report

Managing investments

Governance and decision making

Translating business success into investment management success is notoriously difficult.

The reasons that inspired the entrepreneur to take calculated risks and drive through barriers in their company are not necessarily the attributes of a long-term and patient investor.

Due to the differences in skill set, several Family Offices have opted to invest in familiar territory. For example, some who were previously highly active in Property & Real Estate focus on this area. While they are more familiar with the specific risks faced, a potential problem is that they may have little or no diversification away from that specific asset class.

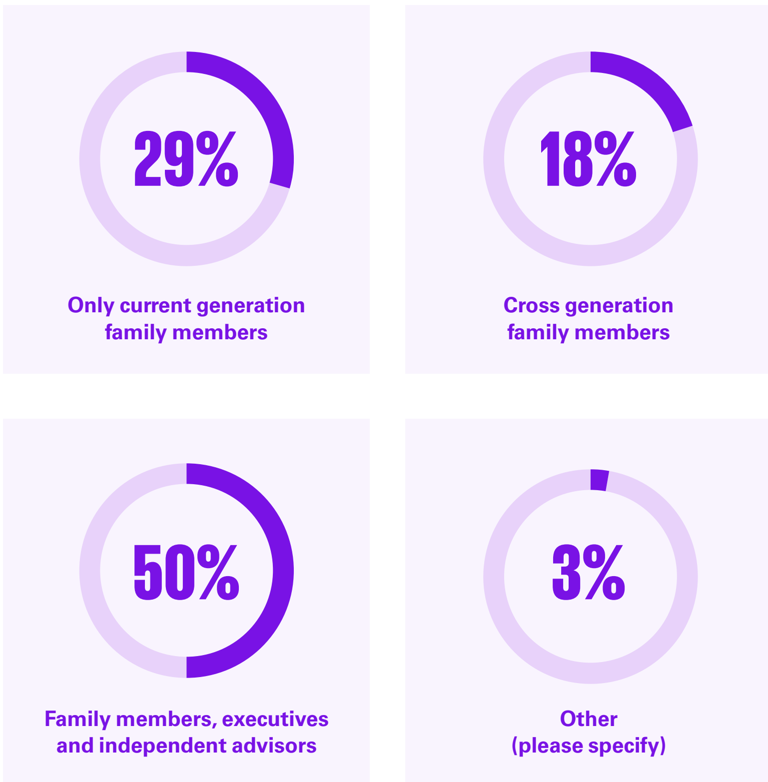
Committee types and members

Considering the different skills required to invest successfully, it was therefore striking that only 43% reported having in place a formal investment committee. Instead, nearly 57% chose to meet on an ad hoc basis without a formal committee.

A possible caveat is that it is likely that committees are formed but not formalised. In response to the question, 'Who sits on your investment committee, or is responsible for making investment decisions?' 50% said family members, executives and independent advisers (see Figure 2).

Figure 2

Who sits on your investment committee, or is responsible for making investment decisions?



In every case there was at least one family member involved in making investment decisions. In more than 20% of cases, there were over four family members involved.

Only one-fifth of respondents reported having no non-family member executives on their investment committees. The most common number of executives was one, and only 15% reported having three or more executives.

In regards to the involvement of independent non-executive directors, they were less common. However, 56% confirmed that they had a non-executive member on their investment committee.

We found that the complexity of the family's governance of the investment management process correlated with both an increase in the family's wealth and the number of generations involved.

More professionals

Whilst it is difficult to draw a definitive conclusion, we have seen an increase in the number of investment professionals engaged by Family Offices, as either employees, within the investment function, or appointed to the boards of Family Office investment committees. Our expectation is that this trend will continue as Family Offices transition ownership and control, and the complexity of the Family Office's portfolio becomes greater.

The trend toward independent directors

IAN DAVIS | HEAD OF PRIVATE WEALTH, MINTER ELLISON

Certainly, best practice among Family Offices is to formally establish a board of directors for the Investment Committee to provide guidance and oversight. It is emerging that the more sophisticated Family Offices will appoint independent directors in addition to family members, as they are recognising the benefits an independent director can provide.

The key rationale for appointing an independent director to an Investment Committee is to bring experience and expertise to assist in establishing investment guidelines and policies, as well as implementing investment strategies. Independent directors can also, through their business networks, broaden the investment opportunities (including through co-investments).

The independent director's ability to provide objectivity and accountability in the face of family dynamics is important too. As an independent director has no existing loyalties to the family members, they provide an impartial voice and greater level of objectivity when it comes to decisions that affect family members. Therefore, an independent director is well placed to provide advice on contentious issues such as board appointments, succession planning and remuneration.

Appointing an independent director can also contribute to the business development of the Family Office as they can introduce fresh perspectives and new skill sets. It provides Family Offices with an opportunity to extend their areas of expertise to foster more critical insights and better decision making.

Managing investments

Setting goals and objectives

Our research sought to determine whether respondents had defined a set of goals and objectives for their wealth portfolios alone. Specifically, they were asked to confirm what their key goals were in managing their financial capital (see Figure 3).

Figure 3

What are the key goals in managing your capital?

(Respondents ranked choices 1 to 3 in importance)

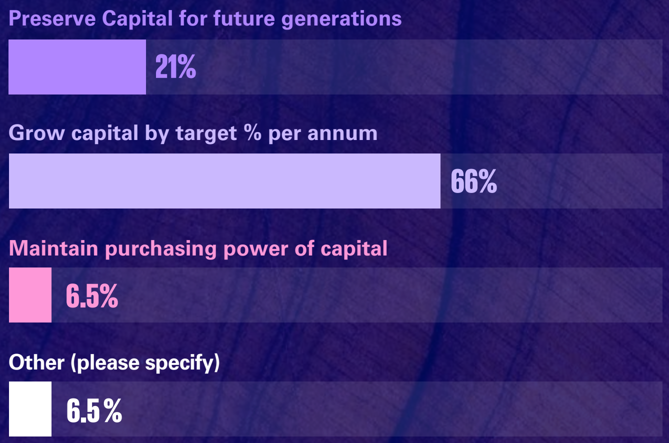


Figure 3 shows that the dominant goal, for nearly two thirds of respondents, was to grow capital by a certain target percentage. A respondent commented in more detail on this goal, demonstrating the numerous issues that Family Office investment teams must deal with in considering how to allocate capital:

"Achieving a minimum benchmark of a Long-Term Target Return Rate on Capital of CPI + 5.5% over a rolling five-year term, and, in so doing applying reasonable risk limits in targeting the benchmark, and ensuring that at all times there is sufficient liquidity to enable the Group to meet regular funding requirements, including the endowment income streams, capital expenditure and any unexpected funding needs."

The goal to maintain purchasing power was key for less than 10%, however this goal recognises that whilst capital may be preserved in 'real terms' after inflation, families can grow in size over each generation, along with their consumption patterns. This requires thought as to what the portfolio's target return should be, to ensure that each generation has the capacity to enjoy a similar lifestyle.

A Family Office member and part of this report's Steering Committee refined this point:

"Families grow faster than wealth compounds. For me, this means that to live the lifestyle I was bought up with, as a family we need to look at how to grow the 'business' five times, to allow for siblings to share. For me, simplistically, that means being careful to invest in assets that have the lowest chance of going to zero and maximum chance for growth."

Investment beliefs

Part of setting goals stems from having 'investment beliefs', which are a set of ideas that form the basis for decision making about an investment portfolio's strategy and objectives. For example, these might pertain to risk and return expectations, or the nature of investments preferred.

David Murray AO, the first guardian of the Future Fund, told the Steering Committee that understanding and defining investment beliefs was fundamental to the development of the fund.

"Without a set of beliefs, there exists the capacity for the management of the portfolio to be constantly changed as circumstances change – as long-term investors it is important for Family Offices to take stock of their own investment beliefs," he said.

Usually, such beliefs would form part of a defined policy of intent. Creating an Investment Policy Statement (IPS) can be the basis for a supportive conversation across the family.

One observer summed up what this policy could be:

> "Having an investment policy needn't be an institutional-level endeavour or require mountains of analysis. Sometimes, the simplest are the best. What is our long-term objective, what is our investment universe and what are our investment rules? An IPS that can be read by anyone in the family regardless of the investment knowledge is also a great starting point and immediately improves engagement."

Return expectations

Respondents were asked to specify a range of total returns they seek to achieve from their portfolios, expressed as a percentage per annum. As figure 4 shows, return expectations and targets are widely set.

By far the largest cohort (61.3%) are targeting total returns on the portfolio of between 6-10% per annum, with around 70% of respondents expecting to earn 10% or less per annum for the next five years.

In the 2016 TTC Wealth Report more than 50% of families expected returns in excess of 10% per annum, showing that return expectations have moderated as investors adapt to what many are terming as a 'lower for longer' return paradigm.

At the extremes, a roughly equivalent number were targeting either 'nominal' real returns (between 1–5%) or 'ambitious' performance of greater than 15%. In further interrogating the responses at these extremes, it was not immediately obvious that any distinct characteristics could be observed that would suggest a higher or lower level of risk tolerance.

Low return:

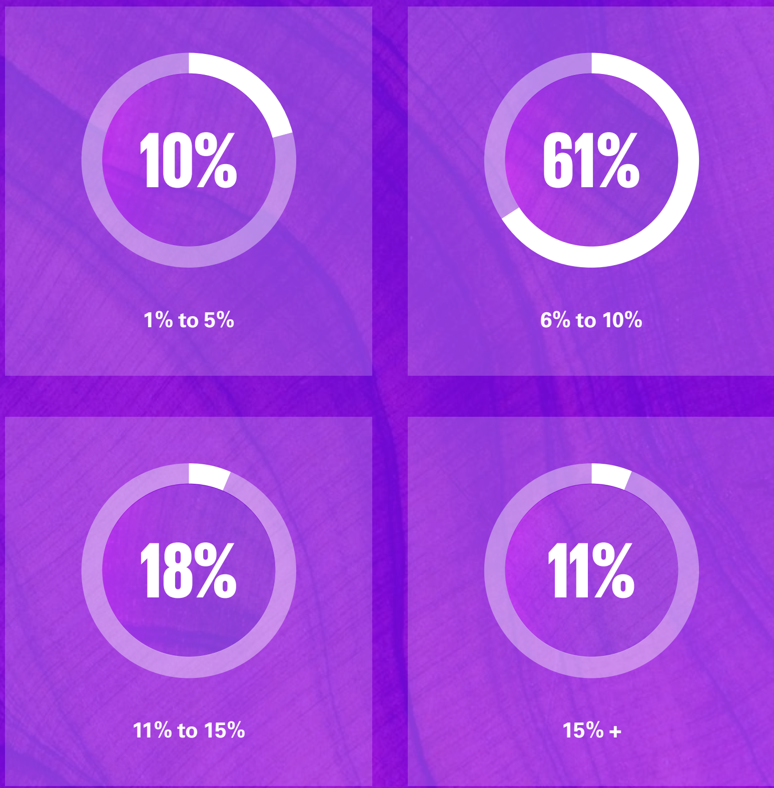
Where the target return was expressed as below 5% per annum, it was not possible to discern from the responses whether this reflected the short-term experience of particular asset classes, or a specific knowledge of what returns to aim for to manage family needs over generations. One notable correlation of those targeting lower returns was that they reported not having a formal investment committee structure in place. Each responded that their goal was to either preserve capital or maintain the purchasing power of capital across generations.

Higher return:

Where respondents' targets were expressed as being greater than 15% per annum, only one suggested that the key goal in managing family capital was to preserve wealth. The rest stated their main goal was to grow capital by a target percentage.

Figure 4

In absolute terms, what is your target total real return objective as a % p.a. over next 5 years?



Potential misalignment on risk

It is possible that there is some dissonance between what respondents stated was their mission and purpose (see earlier section Mission and purpose first), and their key goals in managing capital. This raises the question of whether the 'risk profile' of the family, as a collection of individuals, is properly reflected in their Family Office's investment strategy.

Our interviews suggest that those with the highest growth targets use these as an expected return hurdle for allocating growth capital, rather than a whole-of-portfolio return target. This is typical of the barbell approach to asset allocation, where the portfolio is bifurcated into high-growth assets and defensive assets, most commonly cash. This approach is more common in Family Offices that do not maintain a formal investment strategy, and rather retain cash reserves to invest into high-growth opportunities when these present.

A deeper examination of the reported capital allocations of respondents follows in Managing investments – capital allocation.

Managing investments
implementation

When Family Offices are created, their function is to manage the family's financial wealth. This is a necessary requirement of having to manage the liquidity arising from the event that triggered the formation of the Family Office – for example a family business or inheritance. As noted earlier, this function was recognised by respondents as the primary purpose of their Family Offices.

But how has this purpose been translated into the structure and implementation of the Family Office's investment strategy?

This question has two components:

— Firstly, how has capital been allocated by these offices (see Managing investments – capital allocation)

— Secondly, how have they structured the management of their investment function?

From the responses to the second part of the question, approximately 20% 'wholly' managed their investments in-house (insourcing), with a further 50% managing investments 'predominantly' in-house (suggesting the remaining portion was outsourced).

Insourcing versus outsourcing management

To tease out commonalities in Family Office insourcing versus outsourcing, we asked our participants to identify which asset classes they managed internally (see Figure 5).

It is common for Family Offices with suitable internal resourcing to manage 'traditional' asset classes in-house, such as Cash & Fixed Income, Listed Equities (Australian) and Domestic Property.

While this was supported by our research, the extent to which Real Estate is managed in-house by the Australian Family Office (around 60%) is notably higher than Family Offices globally.

It is interesting to see that there was a significant proportion indicating that they managed their Private Equity portfolio in house. This hints at an increasing sophistication of the Family Office given the increased resourcing required in order to take an active role in sourcing, acquiring and managing the portfolio.

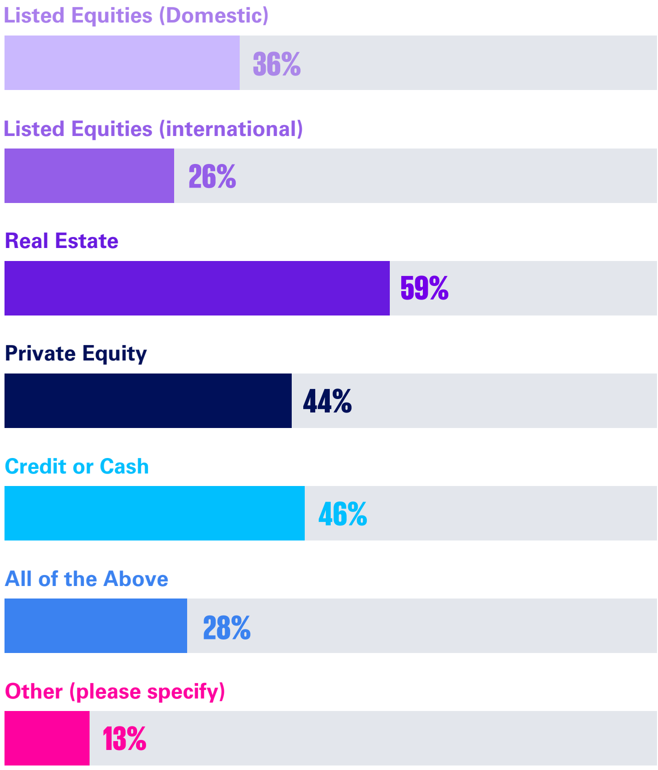
It is reasonable to expect that Family Offices will 'buy' rather than 'build' expertise in areas which require high levels of skill and experience. It is not unusual, therefore, to see the extent to which equity portfolios, both locally and globally, are outsourced to specialist management.

Our study did not interrogate the approach to management of a particular asset class. However, it is possible that an in-house resource will manage a series of external asset managers dedicated to different areas of investment. Where direct equity portfolios are managed in-house, the investment capability would typically be acquired rather than home grown.

Figure 5

Which, if any, of the below asset classes do you manage in house?

(multiple responses possible)



Buy or build' decisions permeate all aspects of Family Office thinking, particularly in terms of recruiting investment management teams or investing in third-party managers.

Striking the balance

As Family Offices mature, and subsequent generations take control, it will be interesting to see whether internal investment management functions evolve, or alternatively become more focused on outsourcing to third-party managers. These insource/outsource decisions are driven either by the ability of the Family Office to carry the cost of hiring investment teams in house, or the ability to raise external capital to spread costs across the investor base. The decision may be dictated by the level of talent available in the market, and whether there is the ability to 'buy' the expertise necessary to execute effectively on desired investment strategies.

Managing investments
capital allocation

The period of collecting data from our respondents, December 2020 to January 2021, was one of abnormality due to COVID-19, within which traditional market assumptions were tested. Central bank intervention and massive fiscal stimulus turned a global economic shutdown into one of the strongest bull runs of the 21st century, proving that it is imprudent to 'bet against the Fed'.

Going forward, investors are faced with new challenges as we enter untested economic waters, threats of inflation, and account deficits that must be unwound. With an unprecedented amount of capital in markets, there has been a compression of 'risk premia' across all asset classes as investors compete for access to a limited pool of opportunity. This diminishing reward for taking risk, paired with increasing uncertainty around future economic conditions, has made the job of the capital allocator harder, and more important.

Perhaps reflecting the market's uncertainty, or reflecting the opportunistic nature of a Family Office's capital allocation, is the fact that less than 40% of our respondents have a formal asset allocation policy in place. As a consequence, it is difficult to dissect what the standard 'strategic asset allocation' of Family Offices was in the early COVID-19 period, but some interesting observations are possible.

Risk is pursued

Despite the returns on risk diminishing, nearly 70% of respondents expected to increase their exposure to risk assets in the next 12 months. For one fourth-generation member of a significant SFO, that response was surprising:

> *"My perception is that the incumbent generation are not risk takers, as they want to preserve the wealth for future generations. So, whilst the current generation may have greater willingness to increase exposure to risk assets, it is still a small component of overall Family Office capital which has taken on 'increased risk'."*

As a possible explanation for that willingness to take on risk during a highly volatile time, one respondent observed:

"Recent astronomical tech gains have perhaps skewed the risk perception of the next generation towards the idea of the 'ease' of wealth generation, thus enticing greater risk-taking behaviour."

For one wealth owner, who manages a growing business and has a sizable pool of capital, their appreciation of risk and allocating capital stands in stark contrast to many 'inheritors'. They commented:

"Originally my percentage of return was set based on my investing objectives and end goal that I had in mind. Also, an important part was my age. I'm young, therefore I'm able to tolerate more risk compared to older investors. Another factor is that I don't need to rely on dividends or distributions from investments as I do have an operational business that supports my lifestyle."

Clearly, the risk appetite of one Family Office may differ markedly from another, hence the difficulty in talking about the respondents' responses in general terms. With that caveat, Figure 6 represents the proportional asset allocation from the responses received.

Some more observations from the results are:

— 9.3% of portfolio capital is allocated to cash.

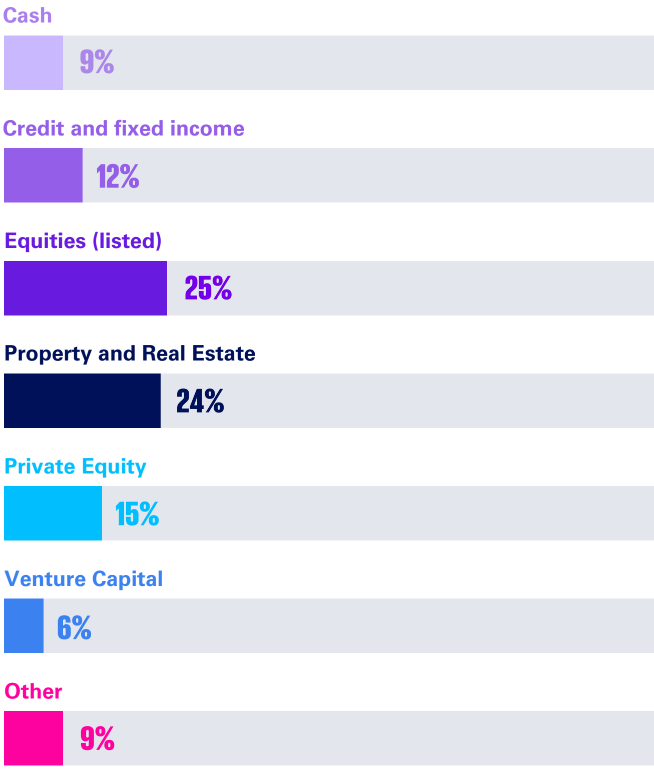
— The high level of investment in direct Property and Real Estate is not surprising considering how important these have been to wealth creation in Australia.

— The most significant increase in exposure has been into Venture Capital (VC), with one quarter of respondents confirming that they now had direct exposure to early-stage VC.

— The allocation to Private Equity is a reflection of the fact that 30% of respondents had direct exposure to operating businesses, a significant proportion having an interest in the original business of the family owners.

Figure 6

Please indicate the approximate proportional allocation of your investment portfolio assets to the below asset classes



VC services

The rise in Family Office interest in emergent asset classes such as VC has been met with a rising service economy in this space. There is an ever-increasing number of education services, accelerators, incubators and advisors moving into the early-stage ecosystem. Of note is the UTS Entrepreneurship Academy, funded by a Sydney based Family Office, and the Wade Institute VC Catalyst program, funded by LaunchVic in Melbourne.

Here, the program directors from UTS and the VC Catalyst program share their insights into the innovation and early-stage investment ecosystem.

Murray Hurps

DIRECTOR OF ENTREPRENEURSHIP, UTS

To me, entrepreneurship means solving problems that matter to you, using technology that excites you, proving yourself, being your own boss, working where, when and how you want, and creating the world you want to exist.

Today, technology is enabling new solutions to be developed that weren't possible before, and these solutions can be distributed to the world at a scale and cost that weren't possible before. These new opportunities in technology-enabled entrepreneurship are ours if we want to pursue them, however, in Australia our startup ecosystem has been in decline.

Startup Muster showed an increase in the number of active startups each year until 2017, with a decline of 12% in 2018 before federal funding for the survey was cut. Seed stage investment into startups across Australia increased until 2017 as well, with a decline in each of the following three years of 60% in total. Early Stage Venture Capital Limited Partnerships fund registrations peaked in 2017 as well, and declined in each of the following years. Add in the impacts of COVID-19 and it paints a bleak picture today of Australia's accelerators, incubators and risk-tolerant investors.

Australia's wealthy have a chance to change this downward trend. To take steps to encourage more people to pursue technology-enabled, ambitious entrepreneurship. To mentor and invest in these new entrepreneurs. To help others to begin the journey that can create a better future Australia, and create the next generation of wealth that will share this commitment to enabling further generations.

At UTS we are committed to inspiring and supporting technology-enabled entrepreneurship, with our UTS Startups program building and now supporting the largest community of student-launched startups in Australia. We will continue our work to help Australia achieve the potential it has in this area, and we encourage you to do the same.

Roshan Ghadamian

DIRECTOR, WADE INSTITUTE VC CATALYST PROGRAM

The Wade Institute VC Catalyst Program is delivered by Wade Institute of Entrepreneurship; an entrepreneurial training academy established in 2015 thanks to a $10 million gift by Australian entrepreneur Peter Wade.

The program caters for a diverse investor base, but includes a high number of primarily next generation Family Office members seeking to develop expertise and networks to facilitate their Family Office's participation in the venture ecosystem.

Participants engage with a curated cohort of diverse participants and experts from local and international markets who share best practice skills, networks, and thought leadership to help craft a strong investment thesis.

VC Catalyst also includes the opportunity for six months of expert mentoring in an experiential learning environment with a curated cohort of like-minded investors, and access to Australia's most innovative entrepreneurial network.

VC Catalyst is funded by LaunchVic, the Victorian Government's startup agency.

Case study

Future Fund as an advanced Family Office

Just as with multi-generational Family Offices, the Australian Government's sovereign wealth fund, Future Fund, has a long-term investment horizon with a mandate to invest for the benefit of future generations. Given the alignment of investment objectives and horizons, the Future Fund serves as a model portfolio for Family Office investors.

In reference to the Future Fund's 30 June 2021 portfolio update, the Fund:

— Has a long-term performance target of 6%

— Achieved the strongest annual return in the Fund's history, 22.2% as at 30 June 2021

— Noted market susceptibility to further shocks despite strength of bounce back

— Remains focused on risk management while navigating a period of increased uncertainty.

These general observations align closely to the realised experience during the early stages of COVID-19 and ongoing views of our survey respondents.

In contrast to a similarity in purpose, objective and sentiment on risk going forward, the Future Fund's reported asset allocation as at 30 June 2021 was in some areas notably divergent to the Family Office average.

Relative to the Future Fund, surveyed families on average held:

Significantly less Listed Equities: 25.4% versus 35.8%

Less of Private Equity: 14.7% versus 17.5%

Significantly more Property: 23.9% versus 5.9%

Significantly more Debt Securities: 11.7% versus 6.6%

Significantly less Alternatives: 14.7% versus 20.9%

Significantly less Cash: 9.6% versus 13.2% for the Future Fund.

This comparison shows the Australian Family Office's predilection towards property assets, with exposure to physical property being four-times higher than the Future Fund. This love for property may also be contributing to the elevated allocation to Debt Securities, as Family Offices have taken on increasing exposures to Property debt over the past 18 months, given the strong relative yields available.

Also of note are the relatively low levels of Cash, with the Future Fund's allocation almost five per cent higher than the average survey respondent's allocation.

In its March 2021 report, it was explained that the Fund's portfolio was positioned at neutral levels of risk.

The Future Fund's justification for its current allocation is summarised by Future Fund CEO, Dr Raphael Arndt:

> "This is designed to allow us to continue to generate returns when markets are strong, while reducing the impact of market falls. This neutral risk positioning and our dynamic approach to managing the portfolio also allows us to selectively deploy capital into new opportunities where we identify them."[2]

2 Future Fund Australia – Performance Update – March 2021

Case study

Sovereign Funds as global proxy for private capital trends

To place these insights in a global perspective, we looked to the 2021 Invesco Global Sovereign Asset Management Study, which surveyed 82 Sovereign Wealth funds globally, representing US$19 trillion in assets.

The Invesco study yielded three key thematic insights which are relevant to this report, being:

01

Focus on risk

The pandemic has been longer and more severe than many expected, leading to rising national debts and growing fiscal deficits as governments look to soften economic impacts. Weakened global economies paired with uncertainty around future growth has led to much more scrutiny around portfolio risk.

— Fixed income can no longer be relied upon as a risk buffer to future black swan events, diversification is now the primary risk control.

— Focus on increasing allocations to alternative assets to generate uncorrelated or lowly correlated return streams.

— Diversifying away from USD exposure after concerns around the sustainability of US debt levels prevail.

02

Focus on liquidity

The COVID-19 pandemic and subsequent market correction has led to increased focus on portfolio liquidity, both to meet future capital requirements and to better take advantage of future opportunities. Trends include:

— Increasing cash allocations.

— Low yields and rising inflation saw fixed income allocations cut to favour public and private equities.

— Use of active management and long-time horizons to justify taking increased equity risk.

03

ESG adoption on the rise

Where the 2017 Invesco Sovereign Wealth Report found a general reluctance to pursue ESG, the 2021 report found the opposite:

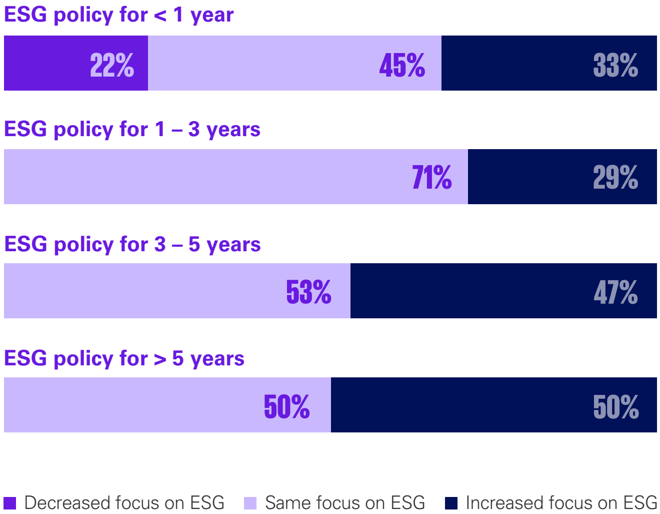
— Majority of sovereign funds have a specific ESG policy (64% in 2021 vs 46% in 2017).

— 63% of Central Banks see climate change as falling within their remit, up from 46% in 2020.

— Rather than creating change, the pandemic has simply accelerated adoption trends already underway (see Figure 7).

Figure 7

Impact of pandemic on ESG focus by ESG maturity (% citations, total sample)



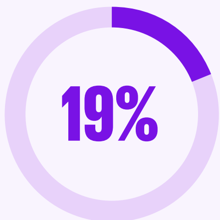
Tailored investment opportunities

As Family Offices have become more visible, the number of investment opportunities that are presented to Family Offices has increased significantly. Many propositions are being described as built solely with Family Offices in mind. References to terms such as 'patient capital' and 'looking for investors with a long-term mindset' are commonly used.

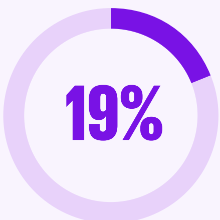
Family Offices have also become more discerning in their approach to sourcing investment opportunities. They may decline to invest in propositions that have been marketed widely before being presented to them first.

The areas of investment that were of most interest to our respondents were:

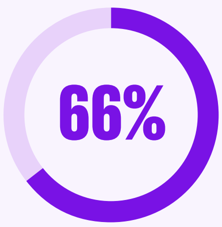
Property & Infrastructure



Healthcare/BioTech/ MedTech



Innovation (technology & data)



Manufacturing and Consumer Goods

Some detailed responses give insight into these interests, such as:

> *"We have various themes that are of interest including sustainability, managing currency debasement and the rise of consumerism in Asia."*

Broad macro themes underpinned several comments, including:

> *"We focus on four themes – energy (including renewables), food (particularly branded), tech for remote working and infrastructure."*

Managing money on behalf of UHNWs

As part of our research, we engaged with a number of MFOs located across Australia and in Singapore and Hong Kong. These are professional services or financial services businesses that have been created to serve the needs of the UHNW marketplace.

Within the cohort of MFOs in our research (23), the vast majority served the needs of between one-to-five families only, and the families were closely aligned.

Reflecting the nature of the MFO's mandate, 56% of the MFO respondents reported having full discretion over their clients' investment strategies, with the balance limited to consulting to clients in an advisory capacity.

It has traditionally been the case that MFOs were seen to serve the needs of families that may not have sufficient wealth to set up their own Family Office. However, based on the reported level of capital that these MFO's were responsible to manage, this is not necessarily the case, with average client funds under management comfortably exceeding that which would make a SFO economically viable.

Instead, the MFO model, bolstered by the improvements in technology that allows ease of access to funds and reporting, is becoming increasingly attractive to substantial families, particularly in South East Asia.

The rigour that is applied to the investment processes of MFOs may also be attractive to multi-generational families over an in-house solution. An MFO could help to avoid conflicts as the profiles of family members diverge, or the number of branches of the family served by the Family Office increases.

Most MFOs globally have been set up as Commercial Family Office operations – led by and sponsored by banks or other financial service providers. They may also be set up independently, typically by ex-wealth management advisers. In Australia, a number of MFOs have emerged to manage a discrete segment of aligned investors. Others have broader ambitions based on their perception that there is a market of mid-tier millionaires[3] that is under-served.

One trend that is emerging internationally, and which Mutual Trust and its merged partner, The Myer Family Company, are an example of in Australia, is the creation of the MFO from the SFO. Previously, this was a way for the SFO to create greater economies of scale and to reduce the costs of management for all clients.

However, now there is a move towards an integration of aligned families into 'buying blocks' – therefore increasing the availability of unique institutional grade investment opportunities. Over the last five years there has been an increase in the number of investment opportunities that are distributed through channels dedicated solely to UHNW buyers. These are essentially platforms, whose role is to connect a network of interested buyers to unique ideas, typically generated by other UHNWs/Family Offices.

3 The term 'mid-tier millionaire' was coined by Capgemini in their World Wealth Report. It refers to wealthy families and individuals in control of assets between $5 million to $30 million.

How is COVID-19 impacting Family Offices?

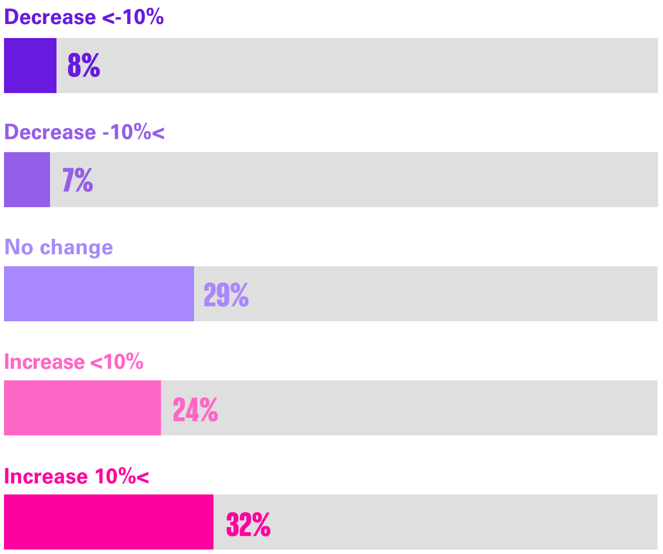
Through our research we wanted to understand the impact COVID-19 has had on the operation of Family Offices to date, and to what extent these changes are likely to remain.

In a recent KPMG survey of CEOs of global publicly listed businesses, that answer has been 'profound'. More than 60% of CEOs surveyed suggested that the pandemic would have permanent impacts on their businesses[4]. However, are things better or more complex for Family Offices?

Our questions focused on the period of late 2020 into early 2021. Looking first at the economic aspect, we asked how the pandemic had impacted the performance of investment portfolios.

Figure 8

What impact has the pandemic had on the performance of your portfolio since Feb 2020?



Evolving impact of COVID-19

It is important to note that since we conducted our research, new strains of COVID-19 have emerged across the world. The latest to affect Australia, in the winter of 2021, is the Delta variant. This has led to enforced lockdowns across Australian cities. Clearly, the impacts of this variant, economically and socially, remain to be seen. We anticipate that our respondents' plans for management of the impact of the virus are now well rehearsed. We have not returned to ask to what extent the impacts of COVID-19 have changed in light of these new circumstances.

4 KPMG Global CEO Outlook Pulse Survey 2021, issued by KPMG Australia, March 2021

By and large, Family Offices did not suffer liquidity issues during the initial COVID-19 lockdowns in Australia in 2020, but instead had already anticipated a market correction prior to March 2020.

For nearly 30% of respondents, there had been no change in the value of their portfolios in the period since February 2020, when the pandemic was declared a health emergency.

However, over 30% reported an increase in the value of their portfolios of greater than 10%. This is illustrative of how the pandemic has impacted populations more broadly. Government stimulus and central bank monetary policies have benefitted wealth holders as asset prices have been inflated.

Several respondents said that prior to COVID-19, they were already anticipating an adjustment in equity prices, due to the perceived stretched valuations of markets at that time. As a consequence, many managed to capture the exponential rise in listed equity markets by timely reinvestment after the initial collapse of equity markets in March 2020.

One member of a Family Office and of our Steering Committee noted:

> *"In March 2020, everyone wanted to lean into the risk and were well positioned to do so during COVID-19 a lot of other Family Offices were in the same position. Prior to this we used to do more high-risk direct investments, however learned a lot of lessons around this and have stepped back unless it is significantly compelling."*

Roughly 15% of respondents reported decreases in portfolio valuations. However, determining the attribution for this is more difficult. For several it may have been a function of their exposure to commercial real estate, however no evidence was obtained to suggest that 'losses had been realised'. It may be the case that overly prudent revaluations had contributed to the suggestion of this decrease.

From the responses given, it appears that the market dislocations did not create liquidity issues for Family Offices, nor result in the significant unwinding of illiquid Private Equity positions as occurred in 2009 after the GFC.

Operational challenges

At an operational level, the management of Family Offices was most impacted by COVID-19 by having to make adjustments for staffing and work conditions. Fully 65% of our respondents mentioned this as being the most significant consequence. However, a nuance to note is that this may reflect that several own operating businesses, and may have been referring to that rather than the staff of their Family Office.

Separately, Family Office landlords reported the need to have rent negotiations with tenants as a major impact. Nearly half reported needing to review budgets and forecasts.

A CFO and second-generation member of a Family Office said:

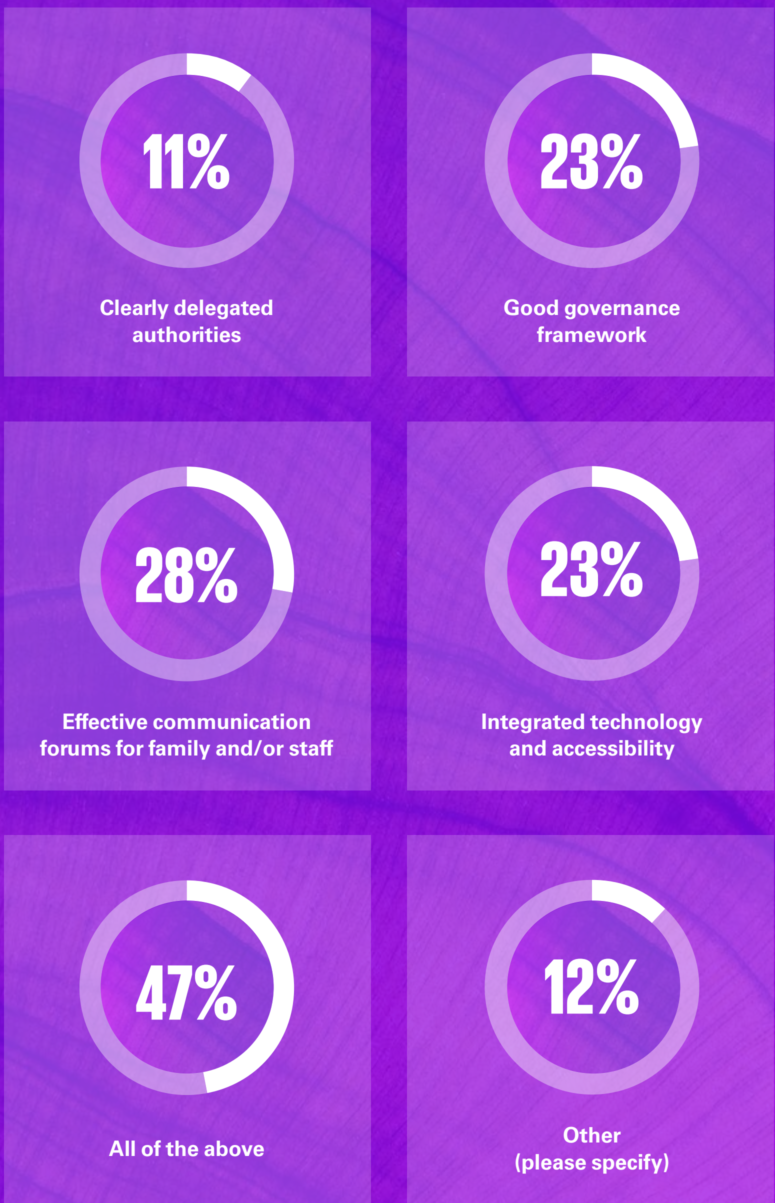
> *"COVID-19 challenged our investments in Retail and Hospitality. Both have rebounded very well and we have a sense of optimism on these."*

We asked what factors helped in responding to the pandemic (see Figure 9), and sought to prove the benefit of families working together jointly, as demonstrated by those running a family business in the KPMG Global Family Business Report: Mastering a Comeback 2021 Survey. It was pleasing to see that the nature of the dynamics of family ownership was a strong contributor to being able to manage the crisis effectively. In particular, having effective communication forums helped.

Figure 9

Which (if any) of the following has helped in responding to the pandemic?

(multiple responses possible)



In context of how the pandemic had altered the way the Family Office delivered services to the family owners, the types of changes mentioned were:

- Heightened focus on a review of the risk management processes (29%)
- Increased access to information to family members via technology (17%)

Another 25% had not implemented any changes to their operations.

When asked whether they felt 'more' or 'less' prepared for the future as a consequence of COVID-19:

- Half indicated they felt that the Family Office was well prepared to deal with the next one-in-100-year event
- Only 8% indicated they were unprepared.

How the future Family Office is forming

As generational changes occur, the influence of future owners of capital is becoming more prominent inside Family Offices. But how ready and willing are families to work through a transition of management, control and ownership of wealth?

Our research sought to understand this from the perspectives of the current generation of ownership and their children. We worked with a dedicated Steering Committee of next generation family members, exploring their engagement with wealth.

Discussion of succession inside the Family Office can be as vexed as it is in a family business. Principals need to consider how their succession process should work – particularly the 70% of respondents who expect their Family Office to last for more than two generations. Over half of respondents confirmed that more than two generations of the family worked in the Family Office. Another 10% had not considered whether the Family Office should continue or not, but felt this was for the next generation to consider.

Encouraging the next generation

Whilst the roles may be fewer, the processes of succession applied by family businesses are equally applicable in the context of the Family Office. One difference is that the Family Office may look to encourage family participation more actively than they encourage participation in the family business, as the family business may need skill sets that are more prescriptive.

When asked if family members were encouraged to play a role in the Family Office, nearly 90% of respondents said that they were encouraged if they had relevant experience; or it was for the individuals to determine participation themselves. Only 7% said that they relied solely on professional management, and therefore family involvement was not encouraged.

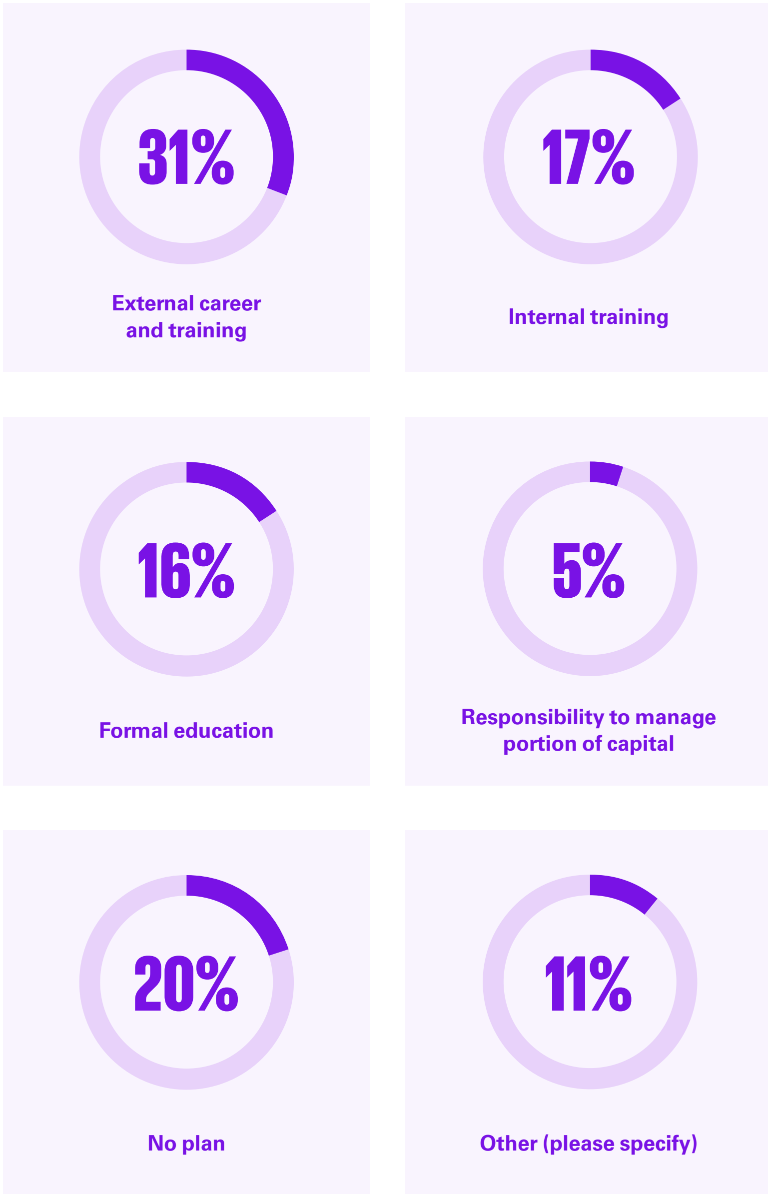
For some, the answer was related to the size of the Family Office. Where the number of family members served by the Family Office was higher, the greater extent to which suggestions of 'conflict of interest' could be made.

A complexity revealed was how to properly remunerate family members working for the Family Office, which could be as complex an issue as it is in family businesses. Where a family member is approached to work for their Family Office, there are numerous ways they are encouraged to prepare for the role (see Figure 10).

> *Managing the process of succession remains the biggest single challenge for wealth owners and business owners alike.*

Figure 10

How are the you, or the next generation, encouraged to prepare for roles in the Family Office/Wealth Structure?



Unchartered waters

With our respondents primarily representing first and second generation wealth owners, the process of succession in the Family Office is largely untested. Where the first generation wealth creator has set up the Family Office, there has been no prior experience to lean on. In the case of second generation wealth creators, this may have been the generation that initially established the Family Office. Accordingly, transition experience appears to be limited, despite the likelihood that for many Family Offices, a transition will take place sooner rather than later.

When we asked how advanced plans for succession were:

- Less than 17% suggested that the transitions were occurring
- 22% felt they were 'very prepared' in their thinking
- Over 35% said they were 'somewhat' prepared
- Nearly 20% confessed to being 'not prepared' in any way, however, this was also a reflection of the relative ages of those in the next generation.

By way of comparison, in a survey of family businesses conducted by KPMG, released in 2018, the preparedness of families for succession of their family business was varied. In general, planning for a change in management was much further advanced than a plan for the transition of the family's ownership of the business as a whole. Many indicated that they had thought about the process, but 45% suggested that no formal plans had been made.

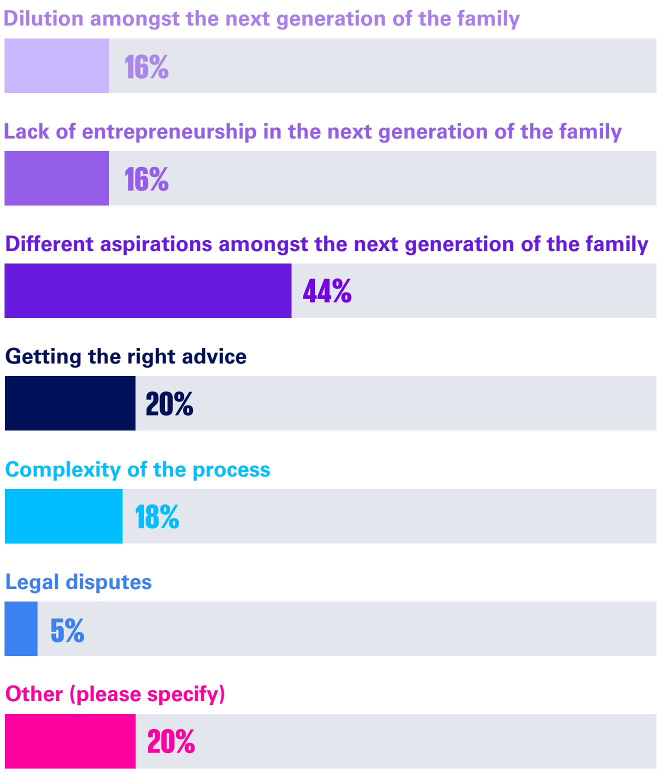
Whether the succession involves the transition of ownership, management and control of an operating business, or the running of a Family Office, there remains a tendency to defer action until forced. Age does not, of itself, seem to be a trigger for these purposes. This indicates that for many wealth owners, the concept of retirement does not ordinarily apply to their own situation.

We asked directly what our respondents were concerned about in wealth transition. The highest response received was having different aspirations (see Figure 11).

Figure 11

What are your biggest concerns in dealing with the transition of family wealth to the next generation of the family?

(multiple responses possible)



The hurdles to successful transition are numerous but not insurmountable.

In contrast to the succession of family business, the capacity to be able to more easily identify one's share as an owner creates its own dilemma and fears of dilution.

Breaking down what each generation, and specifically, each individual's expectations are, is one way to expose any potential issues. It is important to reflect on who drives this process forward, and to what extent those with control allow those differences to materialise into a new approach to managing the family's financial resources.

Other concerns expressed in more detail included:

- *"Retaining the culture of the founder with regards to investment and philanthropy"* – suggesting that there was a lack of confidence that tradition was being observed.
- *"Making sure that the wealth helps rather than hinders"* – showing recognition of the difficulties in inheriting wealth.
- *"Marriage partners of next generation"* – with some wealthy parents not wanting to impede on the freedom of their children, yet apprehensive about the potential choices they may make. In line with this, binding financial agreements have become more important and accepted.

Ready for control

We asked younger family members to think about how ready they felt to inherit control and ownership of their family's financial resources (see Figure 12). For nearly 30%, the concern was whether they will be allowed the freedom to make their own decisions. Some sensed that there would always be someone looking over their shoulder or second guessing them.

Reflecting these sentiments, as both the number of family members increases, and with it the complexity of running the Family Office, one respondent was concerned about: "Each of the families having different objectives and desires in how to manage the family wealth."

Figure 12

What are your biggest concerns in taking responsibility for the future management and control of your family's wealth?

(multiple responses possible)

Impact of the Family Office on wealth succession

How to manage succession varies from family to family. What our research has identified is that the process of transitioning ownership and control of family wealth becomes more structured where a Family Office has been created.

One member of our Steering Committee offered the following advice:

> *"Form a family council, and get everyone to document their goals and expectations. When you have a Family Council, you can then develop a strategy to achieve and execute how the wealth is controlled."*

For an open-minded family, in a Family Council, there is the chance to learn from each other as to how succession may best enable family members to continue working together. For leadership intent on transitioning a model of management that reflects their own perspective, they will need to be able to explain that perspective and the basis for its enforcement. Focusing solely on the form of succession without reference to the future owners will potentially undermine long term inter-generational engagement.

Succession has both a form and a substance. Both need to be managed together by involving the family as a whole.

Enhancing the family's social capital

In 2001, Private Ancillary Funds (PAFs) were introduced in Australia. PAFs had a profound impact on the nature of philanthropy by incentivising wealth holders to create their own foundations in their lifetime. Since then, over 1700 separate private charitable funds have emerged[5].

In the years since, family philanthropy has evolved to become more strategic and purposeful, and families are developing new ways of thinking about how to make an impact financially, socially and environmentally.

We sought to understand the extent to which strategic, purposeful philanthropy has become standard for Family Offices.

Our research found:

- **Over 50%** of respondents had established their own charitable foundation
- **Nearly 90%** had donated to charity within the last 12 months
- **76%** were actively thinking about their 'legacy'
- **38%** felt that a legacy related to the family's capacity to have 'social impact'.

Legacy and impact

In terms of building a legacy, one member of a Family Office's next generation said the legacy was very much for the family:

"The intent is to create a platform for the family that will hopefully help each of us to live a positive and meaningful life."

Another family took the term legacy to be about building impact outside of the family:

"Our discussions around legacy have recognised the importance of 'story telling'. I see my role as being to continue driving conversations around Impact Investing and ESG."

The following comment from a member of the fourth generation of a significant SFO also shows this focus on impact:

"There is definitely a shift from philanthropy to impact. Our legacy was always to support the family in their own endeavours. There is also a shift within the foundation investment portfolio to Impact Investing."

5 In 2001, Australian Government legislation introducing Prescribed Private Funds was enacted. These funds allowed for the development of private philanthropy during the lifetime of their founder. These funds are now known as Private Ancillary Funds.

Rather than giving a 'gift', the aim of many Family Offices is now to build ongoing capacity and scale. For many, this approach is a natural extension of their business careers.

A Family Office founder explained this idea further:

"We decided to try to invest more strategically in the sense that we are looking for leverage and widespread and sustainable outcomes from our investments. We decided to invest in fewer and larger grants, where in an ideal world, we'd have three grants running at any one time in the foundation, rather than lots of little ones which we had previously."

It has also meant that 'measurement' of impact is now key. One respondent explained:

"(we're) really thinking about it as being an investor where you're looking for outcomes. When you're looking for social outcomes, we all know they're harder to measure than financial outcomes, but some of what you measure in financial outcomes, you can measure by being there and understanding and seeing what's going on."

Fostering family engagement

Looking outward to help is important, but for a number of our respondents this started with looking inward to the family. For them, the more strategic approach to philanthropy has not removed its role as the 'glue' that can bind a family across generations. One founder said:

"A priority for me was to find a way to both personally and in more strategic ways to build what I call family capital – and I mean social capital rather than financial capital. There were various reasons why my wife and I decided to set up a foundation, but certainly one of them was about family engagement."

For another, who set up a foundation recently, she was clear that her young children would be involved:

"We didn't give our kids a choice – we said that we're doing this as a family, and you're part of the family, so you're doing it."

While direct, her reasons were altruistic:

"What we want them to feel is that feeling you get when you help somebody, or the feeling you get when you realise that what you're doing is actually meaningful."

Teaming up

The capacity for Family Offices to learn from each other and identify best practice is now common across many aspects of what a Family Office does, including in achieving philanthropic objectives. Our survey showed:

— **Over 30%** have already engaged in collaborations

— **34%** were open to the idea

— **21%** preferred to manage their own grant programmes

— The balance had not collaborated.

Recently formed collaborations of wealthy foundations, both public and private, have a positive focus. One such collaboration is "Mannifera", formed as a collective giving model, its stated mission is "To invest in civil society partners advocating for the structural change we need to strengthen our democracy and build an economy that works for everyone'.

The willingness of philanthropists to actively advocate for change through lobbying is another feature of modern philanthropy. Other issues-led consortia are likely to emerge, such as the Australian Environmental Grantmakers Network. It is possible that the next significant collaboration may be between philanthropists and government, to focus on profound social and environmental needs.

Positive influence

The concept of a family's capital comprising several elements, not just its financial capital, has been popularised by several well-known commentators[6]. One element is a family's capacity to exercise influence and support its community, and, in so doing, enhance its own reputation and standing. Significant wealth owners now see philanthropy as being of prime importance to them and how their wealth is applied. Amongst the most significant have been the emergence of Andrew and Nicola Forrest's Minderoo Foundation, the late Stan Perron's Charitable Foundation, and the late Paul Ramsay's Foundation. The size of the foundations and grant-making means their influence has extended from simply funding projects and initiatives delivered by third parties, to actively developing their own projects. They have also become major influencers and policy advocates.

6 Specifically, James Hughes seminal work "Family Wealth – keeping it in the family: How family members and their advisers preserve human, intellectual and financial assets for generations" – Bloomsbury Press - ISBN: 978-1-576-60151-8

Conscious capitalism

recognising that what we do matters

Our research sought to test the extent to which the influence of younger family members was having on the ways their Family Offices conceptualise risk and return. It revealed that Family Offices have absorbed a great deal of the next generation's concerns surrounding how investor funds are applied, particularly when it comes to having 'conscious capital'.

This means having an awareness of how investment actions may have social and environmental consequences, and adjusting them accordingly. They also know that their actions are being keenly observed by the public and are keen to maintain a positive reputation.

ESG evolution

A significant investment theme globally has been the rise in ESG factors in portfolio construction. In line with a greater focus on conscious capital, our respondents showed an increased influence in awareness and actions regarding ESG issues.

While integration of ESG principals into portfolio construction decision making is on the rise, there is very little universality in the manner or speed with which these policies are being integrated.

One striking example, was how important factoring in climate change into investment decision making was to respondents:

— **Just over 10%** considered it to be extremely important

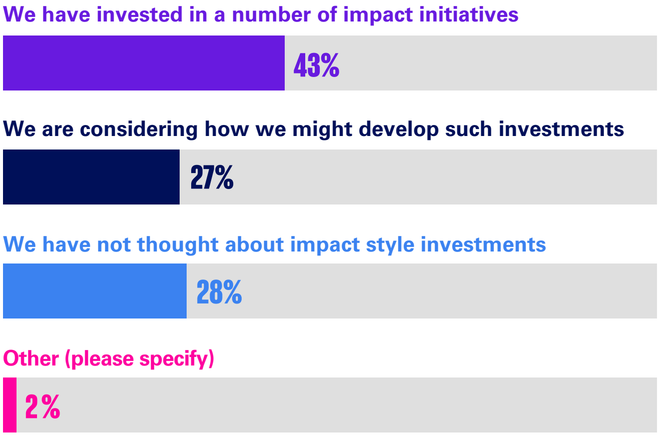
— **Nearly 40%** were neutral on the issue

— **14%** considered the issue was not important

Within the context of the findings displayed in Figure 13, (see page 57), the high level of interest in 'impact' investing suggests that the prevalence of ESG and specifically Climate Change considerations in portfolio construction will increase over time.

Figure 13

To what extent have you considered impact investing?



As ESG has driven corporate culture and influenced institutional investment, Family Offices are becoming increasingly conscious of building ESG processes into their investment decision making.

Impact Investments

The extent to which Family Offices had crossed the boundary from being conscious in their investment decision making, to being more deliberate in the outcomes they sought to achieve, was reflected by the percentage of respondents who reported having made a number of 'Impact Investments' – over 40%. Another 27% were considering how they might do so.

Impact Investments are typically made by family foundations and endowments investing a quantity of their foundation as a direct expression of their philanthropic purpose. An Impact Investment may not sit within the family's main pool of investments, and could even be managed by a family member rather than the investment team.

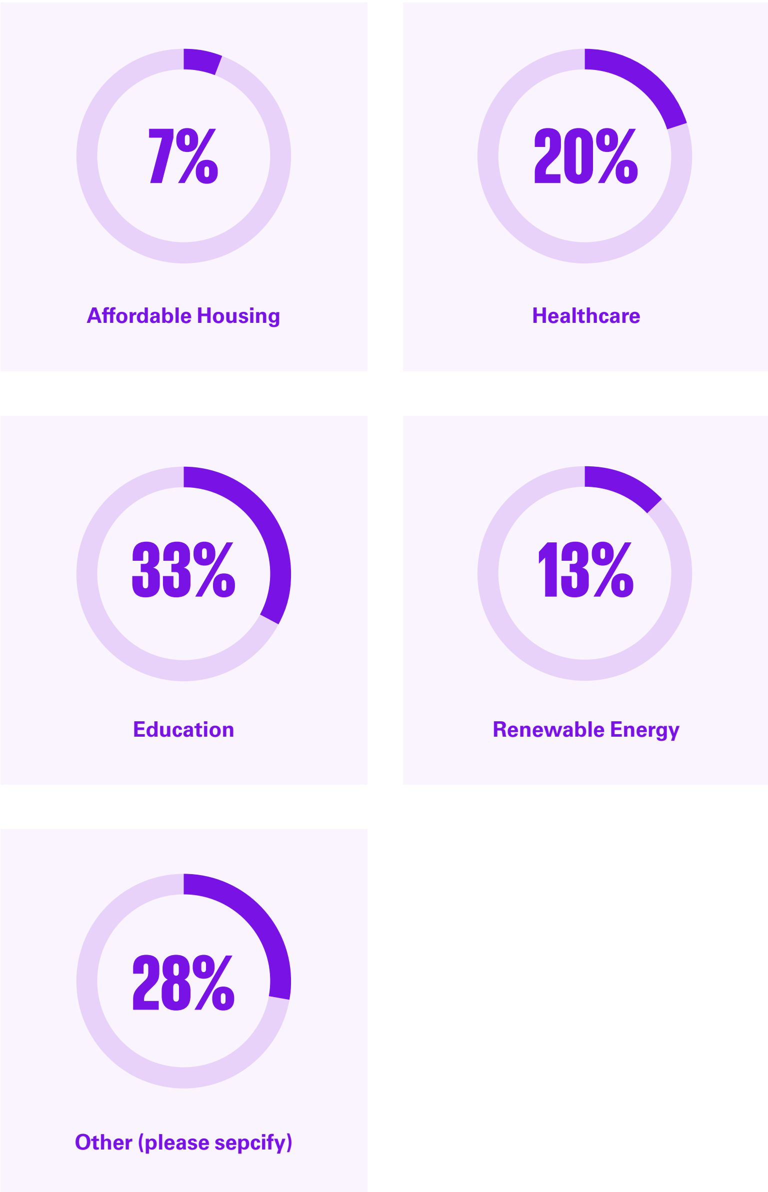
Impact Investing has traditionally been the domain of UHNW investors, which is due to the fact that the return profile of such investments does not focus solely on financial return, but factors in social and environmental outcomes. This is not something that institutional investors are easily able to support due to their growth mandates.

There is also a limited number of investment opportunities at scale. However, as seen by the recent investment of $500 million by Temasek, the Singaporean Government's investment arm, into Leapfrog Investments, this is changing. The concept of businesses being run with 'profit for purpose' is now a recognised model.

Where respondents had invested in impact, Figure 14 shows their areasof interest.

Figure 14

If you have invested or are starting to invest in impact — what areas are you interested in?



Specific areas of investment interest included renewable energy and sustainable eco-systems including funding initiatives that supported the concept of the 'circular economy'[7].

Within renewable energy, there has been a trend of Family Offices using their perpetual time horizons to back emerging technologies that are at, or near the cusp of, commercialisation. One such technology is hydrogen storage, which has had support from investors including Andrew Forrest and Mike Cannon-Brookes.

7 A circular economy is a systemic approach to economic development designed to benefit businesses, society, and the environment – see Ellen Macarthur Foundation – The Circular Economy in Details

The power of hydrogen

Hydrogen is emerging as a leading way to help the world find a path to a zero-emission future. Hydrogen can be used to fuel electricity, transportation, heating and steel refinement, for example. The industry has seen vast investment internationally, and is a potential point of interest for Family Offices looking to invest consciously. The Hydrogen Council forecasts hydrogen to become a USD $2.5 trillion industry by 2050[8].

LAVO is one example of new technology being created to support the use of hydrogen. The Australian product enables residential and industrial scale storage and distribution of renewable power at the source of generation. Integrated with solar generation, LAVO uses excess solar power to generate green hydrogen, storing it safely in a metal hydride, converting back to electricity, and distributed when needed. LAVO is the first commercialisation from a partnership between Providence Asset Group and University of New South Wales. The partnership was established to commercialise new technologies and continue research and development for optimisation and discovery.

8 https://hydrogencouncil.com/wp-content/uploads/2017/11/Hydrogen-scaling-up-Hydrogen-Council.pdf

Running the Family Office

As families and their Family Offices become more financially sophisticated and professional, we wanted to understand what impact this has had on the operation of the office and administration of their family's wealth.

Within the Family Office, our respondents said the most significant costs related to the running of the investments are salary and remuneration, technology and IT infrastructure, and third-party investment management fees. Other administration costs, such as asset custody, have decreased as a consequence of new technologies.

In most Family Offices, there are also costs related to the management of non-income producing assets such as yachts. Managing these costs requires confirming exactly whose responsibility it is for their maintenance and costs and formalising that process.

Data driven Family Offices

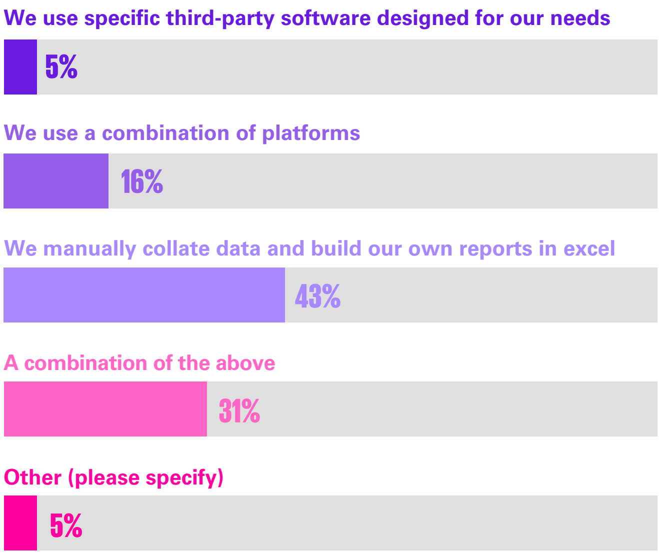
In today's data-driven environment, there are numerous options available to Family Offices to help collect data, analyse it and share that information in a meaningful way. We found that increasingly, Family Offices are looking for solutions from both service and software providers based in the US and Europe. The growth of virtual conferences makes this possible. Often these providers do not take ownership of assets in any way. Instead, they aggregate data from several sources and then present that information back to the Family Office through customised reporting.

Legacy technology

Despite their interest in new technology solutions, several responses suggested that many Family Offices are currently relying on legacy technology to support reporting capability. Figure 15 shows the extent to which Family Offices use specialist software as part of their investment reporting.

Figure 15

To what extent do you use specialist software in your investment reporting?



Over 40% of Family Offices reported they were collating data manually to build their own reports in Excel. Another 16% used Excel in conjunction with other reporting software, and 30% used another combination.

One respondent suggested that Family Offices are lacking awareness of the costs of the manual administration:

> *"Excel is an excellent tool; it is customisable and inexpensive in terms of software costs. What we don't see taken into consideration is staff costs for manual management of assets. I think if Family Offices broke down the time and effort it takes to manage the reporting and data analytics, there would be more moving to digitisation."*

We also found that a number of Family Offices have not invested time to become familiar with technology that could enable deeper and more insightful sharing of information with family members.

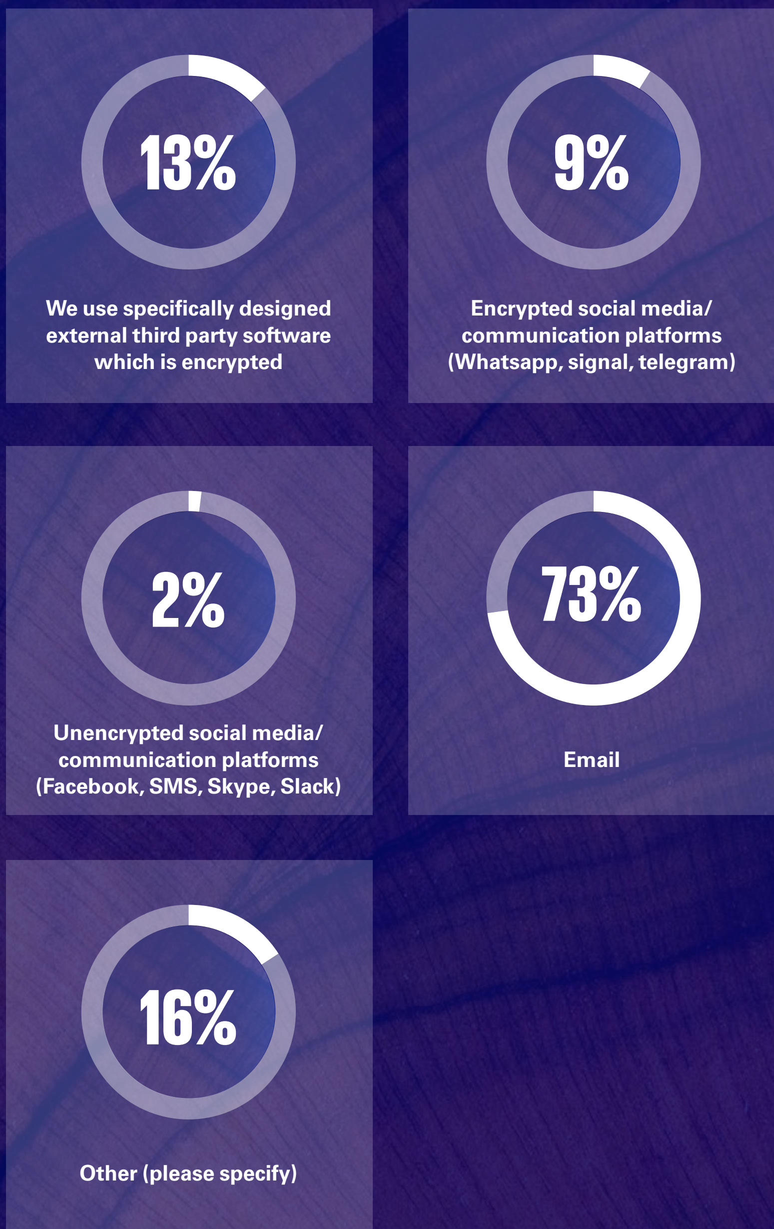
For example, in response to the question, 'How do you use technology when reporting to family members?', the emphasis was to rely on tried and trusted methods of communication – largely email (72.72%) (see Figure 16).

While this form of communication may not enable the rich data reporting that some specialist software can provide, it could also expose the Family Office to cyber security risks.

Figure 16

How do you use technology when reporting to family members?

(multiple responses possible)



Cyber security risks

When it comes to cyber security threats, our research found that over half of our respondents had received several threats to their security. Just over one quarter (26%) of our respondents had experienced a cyber attack. Close to 60% said they were actively considering how to manage cyber security risks as part of their risk management process.

Figure 17

How are you managing the threat of security risks?

Over 53% of respondents reported being subject to cyber security threats.

A study from Boston Private[9] reported that several factors affected the capacity of Family Offices to manage risks.

These included:

- Lack of risk awareness amongst family and Family Office staff
- General complacency or prioritisation of convenience over security
- Underestimation of the threats
- Difficulty in identifying appropriate vendors suitable to the Family Office market.

Family Offices now need to be more vigilant in the management of risks in general – not just investment risks.

9 Boston Private – 2021 Family Office – Surveying the Risk and Threat Landscape to Family Offices

Staffing – recruitment and retention

As a family's financial affairs become more diverse, there is often an increase in the number of staff employed by the Family Office. Some have over 100 staff across separate operations and functions, doing everything from managing a family's farming assets, captaining boats or piloting helicopters.

Within the Family Office itself, role descriptions and responsibilities can typically be unclear. The Chief Financial Officer may double as the Chief Risk Officer, with an overlap in managing regulation and compliance with the Chief Investment Officer.

Consequently, benchmarking a market rate of remuneration is not straightforward. Likewise, it can be complex to set specific performance goals from which a discretionary bonus may be paid.

Whilst some may find a lack of formal structure disorientating, Family Offices are becoming increasingly attractive places to work, competing with larger institutions for quality staff. Family Office employees often have influence, a broader remit, and greater control of outcomes.

Globally, the demand for experienced Family Office staff is being met with an increase in recruitment dedicated to the Family Office market.

Performance assessment

We asked our participants how the performance of the Family Office was measured, and the most significant measurement was the movement in the value of financial assets year-on-year (see Figure 18).

Figure 18

How do you measure the performance of the Family Office/Wealth Structure?

(multiple responses possible)

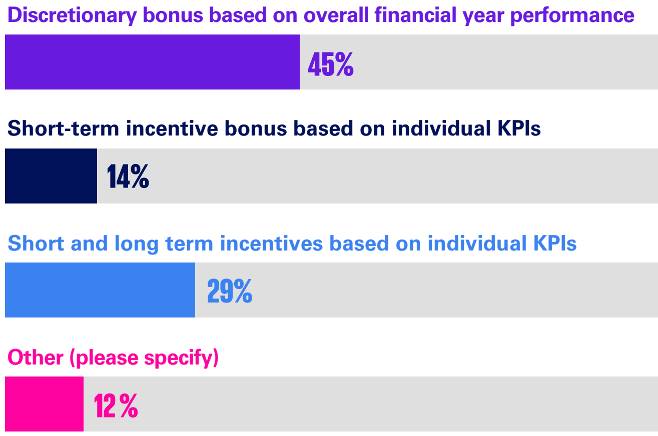
It follows that in assessing individual staff performance, the movement in the value of financial assets remains a key measure. Our study suggests that individual performance is measured as a combination of 'qualitative and quantitative' factors with over 65% of Family Offices using both.

Recognising the focus on the performance of financial assets, we asked whether certain executives were allowed to invest alongside the family. Several executives would probably have played a role in reviewing investments and undertaking operational due diligence. Roughly 60% of respondents said that, where appropriate, this co-investment was possible. However, a sizable minority preferred to separate family investments. With Family Offices generally not offering long term equity incentives, the incentive of co-investing alongside the family represents a compromise. To what extent the development of more sophisticated 'shadow equity'[10] reward arrangements are made remains to be seen.

In regards to rewards, Figure 19 indicates that discretion still dictates both whether a bonus is paid, and the amount. Just over 40% of respondents suggested that additional staff rewards were calculated based on the achievement of KPIs.

Figure 19

How do you reward staff by way of additional incentives?



Most Family Offices prefer to exercise discretion when rewarding executives by way of bonus.

However, increasingly, Family Offices are looking to benchmark Family Office roles and understand how others are structuring rewards.

10 A shadow equity arrangement grants employees a right to receive compensation based on the value of the company's equity. In cases of private companies, the arrangement would specify how that equity is to be valued.

The future of the Family Office

This report has shown that Family Offices are on the rise in Australia. They are continuing to professionalise, to refine their mission and purpose, and are looking to the next generation for influence on how they can make an impact beyond their own building of wealth.

They are increasingly aware that the way they invest is scrutinised and their reputations are always at risk.

As a source of funding for private enterprise they have never been as active. Their influence, particularly, in funding early-stage venture capital and innovation, is becoming more strategic. As a lure for professional skills and talent they are increasingly attractive.

Based on our findings, some issues for the Family Office to consider include:

- How to work closely together to avoid fragmentation of wealth and loss of influence by clearly defining their own expectations of the Family Office.
- A shift in the dynamics of running and operating a Family Office towards a more efficient approach embracing technology.
- Building and demonstrating effective governance, to enable effective decision making focused on the family's long-term vision.
- Reviewing the family's mission and purpose and its alignment across generations.
- Educating family members of cyber security risks, and being able to respond to any risk issues effectively.

Family Offices are cognisant of the challenges that lay ahead and the changes they must manage.

We believe the following will be emerging trends for the Family Office as a sector into the next decade:

— As financial markets transition from unprecedented central bank and government stimulus, achieving return targets will be more challenging. Based on current levels reported from our respondents, there is likely to be a greater focus on having appropriate policies in place as well as having experienced investment committee members on board to guide the Family Office through volatility.

— The rate at which new Family Offices are created in Australia will increase as equity and real estate asset values remain supported and inflate.

— The increasing size and depth of the sector in Australia and across South East Asia means that Family Offices will continue to attract skills, talent and resources from the financial services sector and from commerce more generally. This will result in an increase in the costs of hiring for and managing Family Offices as salary and wage costs compete for talent.

— Family Offices will need to benchmark their performance, culture and purpose as a basis for competing for talent.

— Third-party technology platforms able to collate data efficiently and accurately will continue to be more easily accessible and drive down administration costs.

To conclude, we consider from our findings that Wealth in Transition means more than how ownership and control changes – it is the transition of the meaning of wealth and what it means to be wealthy. Recognising and acting on this will place a Family Office in a stronger position for lasting impact.

Acknowledgements

Steering Committee

David Murray AO

David has 40 years' experience in financial services, with expertise in banking, wealth management and regulation. He served as CEO of the Commonwealth Bank of Australia from 1992 to 2005 and as the inaugural Chairman of the Australian Future Fund from 2006 to 2012. He was also the inaugural chair of the International Forum of Sovereign Wealth Funds. David chaired the Financial System Inquiry, which reported to the Australian Government in December 2014. He has previously served as a member of the Finance Sector Advisory Council and the APEC Business Advisory Council.

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Joel has had a thirty year career in Australia, Europe, Asia and North America in global capital markets, investment management, financial services and the family office sector. Joel has experience with global funds management businesses across multiple business sectors and asset classes including public and private equity, structured equity and venture capital. Joel has held leadership roles at Aberdeen Asset Management, ING Group, the US Prudential and JP Morgan in London and recently co-founded Felix Bay Group, a family office advisory business.

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Ben is Director of Global Investments at the Gandel Group, the Gandel Family Office. He has a Bachelor of Commerce in Accounting and Finance and IT from the University of Witwatersrand, an MBA from Melbourne University, and a Master of Applied Finance from the Financial Services Institute of Australia.

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Olivia is an Executive Director at BCDO Capital, where she co-manages a portfolio of investments in the hospitality, property and technology sectors. She also leads strategy, governance, finance and risk planning for BCDO Capital and has a particular interest in Private Equity and VC markets.

Previously, Olivia was a Management Consultant with EY in their advisory practice, delivering large scale transformation programs and consulting in organisational behaviour, change management, diversity, customer experience and communications.

Olivia played an important part in the development of this report as she was also a member of the Steering Committee for the Report.

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Massimo works in his Family Office, Angophora Capital, managing a diversified portfolio of investments across all asset classes. Previously, he worked as a Project Engineer and then Project Manager for a commercial construction company. He has also worked as a Commercial Manager in an ASX listed asset maintenance and services business.

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Ed is developing his entrepreneurial interests as an investor in, and executive of, emerging businesses. He is the Acting CEO at Placie, a Mobility-as-a-Service (MaaS) business, and the co-founder of The Next Co., a global network of next generation Family Offices focusing on investment, education, collaboration and networking. Ed is also a Non-Executive director of Wallaby Downs Pty Ltd, a private investment company. Ed has worked as a Business Development Manager at Pendal Group and as an Associate at JP in Morgan in its Chief Investment Office and Treasury departments.

The Table Club

James Burkitt

James is the Founder & CEO of The Table Club. James started his career as a Chartered Accountant, then moved into the investment management industry, and worked at Rothschild and Colonial First State. He established his own investment and advisory firm in 1993 where he has acted as both agent and Principal in various capacities and investments. He was the Co-Founder of Rainmaker in 1993, which was sold to Thomson Reuters in 2002. He then purchased Strategic Super and sold to Zurich in 2006. He has held various director and advisory roles for prominent Australian Family Offices from 1993 to now.

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Perry is an Investment Associate with The Table Club, specialising in strategy and investment due diligence. Previously, Perry worked in the institutional investment consulting industry, working with superannuation and endowment clients to define strategic objectives, asset allocation, portfolio construction, manager selection, and portfolio monitoring.

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Partner in Charge, Family Business & Private Clients, KPMG Australia

Robyn is a trusted adviser to privately held businesses including family businesses and Family Offices. She also provides experience and capability in self-managed superannuation funds. Robyn delivers strategic financial and tax advice tailored to their business and the challenges they face. Robyn has assisted many family and private groups with asset protection, succession planning, tax effective structuring and meeting their philanthropic objectives.

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Partner, Head of Tax, Enterprise, KPMG Australia

Clive has more than 28 years' experience in complex tax consulting to large corporate and mid-market clients as well as deep expertise in income tax, capital gains tax and international tax. He joined KPMG in 2017.

He has extensive experience in managing the tax aspects of M&A transactions and Australian Tax Office (ATO) audits and reviews. Clive specialises in tax planning and structuring for large private business, complex family office groups, and high-wealth families, and develops tax solutions that add long-term value.

Clive has a published book titled "*How to Optimise Business Tax – Strategies, Structures, Solutions*".

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Partner, Enterprise, KPMG Australia

Kaajal has over 12 years' experience advising private clients, and specialises in working with family-owned groups to guide them through the challenges of ownership succession, leadership succession, structuring and governance mechanisms and developing the next generation. She serves as independent adviser to a number of family-owned and not-for-profit boards where she is able to apply her deep commercial expertise for the benefit of her clients. Kaajal particularly enjoys working with family businesses and their owners because they bring out her empathetic nature as well as her commercial expertise.

Katherine Karcz

Director, Family Business & Private Clients, KPMG Australia

Katherine is a trusted adviser with more than 10 years' experience in providing advice to family owned, privately owned and Private Equity-backed businesses, as well as HNW families and their Family Offices. She works closely with her private clients to provide financial, taxation, on-demand CFO, structuring and governance advice. Katherine enjoys working with family owned groups and guiding them through the challenges of ownership and leadership succession, structuring and governance mechanisms.

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