Guide: Family businesses

The eight fundamentals of family business

1. Family involvement in any business has to be an integral part of the business' successful future and therefore provided for in the business plan.

2. Incoming family members should have a skill set that is needed by the firm. The recruitment process should embody the procedures used for non-family appointments with proper employment contracts in place and regular appraisals undertaken.

3. The existing controlling family members (often the founders) and the newcomer(s) must discuss the dynamics of succession prior to any new blood joining. These discussions must be formal and minuted and are an opportunity to ensure there are no misunderstandings going forward.

4. An induction process should be implemented so the new member is fully immersed in the systems and culture of the business, and ongoing training provided for.

5. Financial implications must be considered including remuneration levels, buying in opportunities, business expansion and its funding and security of shareholding in the event of a relationship break down and the paying out of departing family members.

6. If the plan is to sell to the newcomer, a formal succession plan needs to be prepared with a timeline put in place so there are no misunderstandings. The succession plan should be regularly monitored.

7. Ongoing communication between the key players is essential and formal management meeting times 'carved in stone'.

8. The appointment of a non-family member to the business' governing body should provide an independent approach to important strategic matters and may provide an initial 'go to person' in the early stages of conflict resolution.

Spouses in business

A large number of small to medium sized New Zealand businesses are run by spouses working together.

The stereotypical contracting firm where the husband is on the tools and wife runs the office is still the 'norm' for thousands of Kiwi firms.

What processes and systems need to be put in place to ensure these very closely held businesses work?

Successful business planning

Successful businesses plan ahead and document decisions, processes and responsibilities. If the business is newly formed you can get the planning done at day one which includes role descriptions for the spouses working together.

If a spouse is joining an existing business operated by his/her partner then their involvement needs to be carefully thought out, written into the business plan and agreed upon by both spouses.

As with any new appointment the newcomer will perform much better if they are inducted properly and given a thorough understanding of the business' goals, values and processes. Courses and seminars may be useful in ensuring the incoming spouse has the skill set necessary for the role.

Effective meeting time

Communication between spouses is a critical success factor in any family run business. Regular meetings should be held and minuted where the business' performance is reviewed and decisions made on key areas. Time for meetings should be allowed within normal business hours so the meeting is formally conducted and not held while eating the evening meal!

In some instances where an independent advisor, eg accountant, mentor or coach is appointed this person may be used to chair the management meeting.

Financial management

Strong control of this essential aspect of business is vital. Cash flow and profitability needs to be monitored and measured closely as financial problems will impact not just on the business but probably on the couple's relationship and family life.

If one spouse is responsible for the business' finances, the other spouse should be regularly updated on financial key result areas so if any problem arises it can be tackled jointly and hopefully resolved quickly.

If possible it is prudent that business assets be kept separate from private assets to ensure that the business can continue to operate if the business breaks down.

Relationship breakdowns

Relationship breakdowns are prevalent and can have an adverse affect on the success of a business. A happy couple may see no reason to doubt the solidity of their relationship, and therefore, no reason to provide for the business' future in the event of a breakup.

A precedent for preparing for a relationship bust up is the need for life insurance. No one in the prime of life expects to die but they sign up for life insurance just in case they do! The odds of a relationship breakup are probably higher than dying early so a written agreement at the time of starting a business together or, when a spouse joins is necessary and should include the following:

- How and who will operate the business during the critical period between breakup and settlement;
- What access will the resigning partner have to business information in the interim;
- What rules will apply to the financial running of the firm eg paying bills out of the business account, signing loan documentation;
- How and who will value the business;
- Over what period the departing spouse's equity will be paid out.

Seek advice

Obviously when a new spouse joins his/her partner's family business the provisions for dissolution can be included in a Property Relationship Agreement (ie pre-nuptial agreement) and is strongly recommended.

This and other structural matters can be discussed with advisors such as a chartered accountant or lawyer. An effective way of covering all the bases is to have a round table meeting with key advisors so that many issues are flushed out, discussed and acted upon.

Conflicts within family businesses

Being in business with others will often present challenges and the potential for conflict.

Involving family members in the business mix can introduce dynamics that may require firm management skills to focus the attention of family employees on the critical business issues.

What are the potential areas of conflict?

Generational attitudes and values

- Throughout the ages the family head and the young heir have 'locked horns' over the latter's desire to introduce change to business process and the former's stubbornness to maintain the status quo. Now more so than ever with rampant changes in technology, the processes of manufacturing, retailing, farming and service delivery are being constantly revolutionised.
- Handing over the reigns from the old to the new guard progressively and successfully can trigger angst between family members.
- Differences in work ethic and hours or work can result in disharmony and misunderstanding.

Financial contributions and expectations

- Younger family members may require higher remuneration levels than the previous generation at their stage.
- Capital contributions may be unequal resulting in uneven distributions of profit.
- A retiring family member may still be on the payroll on an 'earnout arrangement' placing pressure on a business cash flow.
- Finance for expansion may require security to be provided inequitably.

The influence of extended family

- The relationship between immediate family members may change with the influence of spouses and in-laws.
- Relationship breakups place stress on individual family members and if no pre-nuptial agreement is in place can lead to an extended period of uncertainty while business interests are valued and the departing member paid out.

Personalities

Many organisations when fitting a job vacancy will ask the candidates to undergo a behavioural profile such as DiSC or Myers-Briggs. Obviously a dominant outgoing person would not fit the bill for a back room processing job and placing a family member in a business is no different. At times family members brought in will not be an ideal personality fit for their job. After all, they could be 'a chip off the old block' and clash with their parent(s) or sibling(s).

Dispute Resolution

Despite putting in place the recommended agreements, policies and procedures, disputes can occur and escalate in a family business. The older the business and the more fragmented the family ownership becomes, the potential increases for disagreements on management style, remuneration, capital input, expansion, succession planning and frequently control.

How do family businesses deal with a meltdown between their members? Firstly, the sparring/warring factions must agree that the business operations (including staff) must not be put in jeopardy and a rational dispute resolution approach taken.

Agreements put in place to handle disputes should be dusted off, read and followed to the letter. It is good practice for the disputing parties to write down their grievances so there is no misunderstanding in their resolution and application of the agreed upon processes.

Get objective help

If the in-house procedures for resolving the dispute are unsuccessful, it is time to seek advice from the business' close advisers, e.g. chartered accountant, lawyer, mentor. Often these advisors will have a close association with the business and family but can provide an objective view of the disputed matters as they are outside both the management team and family.

Mediation

If the trusted advisor feels too close to the family to recommend a compromise or solution, a professional mediator may be appointed to listen to the parties and try to broker an agreement. While a mediator does not make a binding decision on either party, it is in the interest of both sides to mediate a settlement to avoid expensive, stressful and prolonged legal action.

Arbitration

If the dispute is of a serious nature, or both parties are intransigent, arbitration may be the way forward. The family agreement signed by both parties may provide guidance on the organisation or individual that should be appointed to arbitrate on the dispute and make a binding ruling to settle it.

An arbitrated decision may be able to be appealed to the Family Court or High Court in which case the legal system should provide the remedy.

Family Business Checklist

	The following is a summary of the key items which should be considered when planning a family business and prior to hiring a family member	✓
1.	Business plan written and adopted for family involvement	☐
2.	Written agreement prepared and signed providing for a relationship breakdown between any family members (can be part of a pre-nuptial agreement)	☐
3.	Remuneration levels set and agreed	☐
4.	Employment agreements and job descriptions prepared for family positions	☐
5.	Induction process documented for family appointments	☐
6.	Family/business communication policy documented and agreed upon	☐
7.	Management meeting format and times documented and agreed upon	☐
8.	New member buy in arrangements documented and agreed upon	☐
9.	Dividend and bonus policies prepared and agreed upon	☐
10.	Succession plan documented and agreed upon including timeline	☐
11.	Financial reporting procedures documented and agreed upon	☐
12.	Appointment of a non-family director considered and agreed upon	☐
13.	Loan advances documented by deed of acknowledgement of debt and executed by all parties	☐

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