Family *Affairs*

Juliette Johnson discusses how protecting the future of your family business is reliant on solving tomorrow's predictable problems today.

Strong businesses are constantly looking ahead, trying to forecast future commercial risks and opportunities, with varying degrees of success. Family companies need to do this too, but they are exposed to an additional sort of risk factor – family risk – which can undermine an unprepared business just as quickly and comprehensively as more conventional threats.

Let's think for a moment about the challenges of some common scenarios for a family business.

When family businesses make the transition from the second to third generation, for example, cousins will likely become involved as both employees and shareholders. This challenges family cohesiveness because, unlike second-generation siblings, cousins will have been raised in different households with different parents, different values and different perspectives on the family business.

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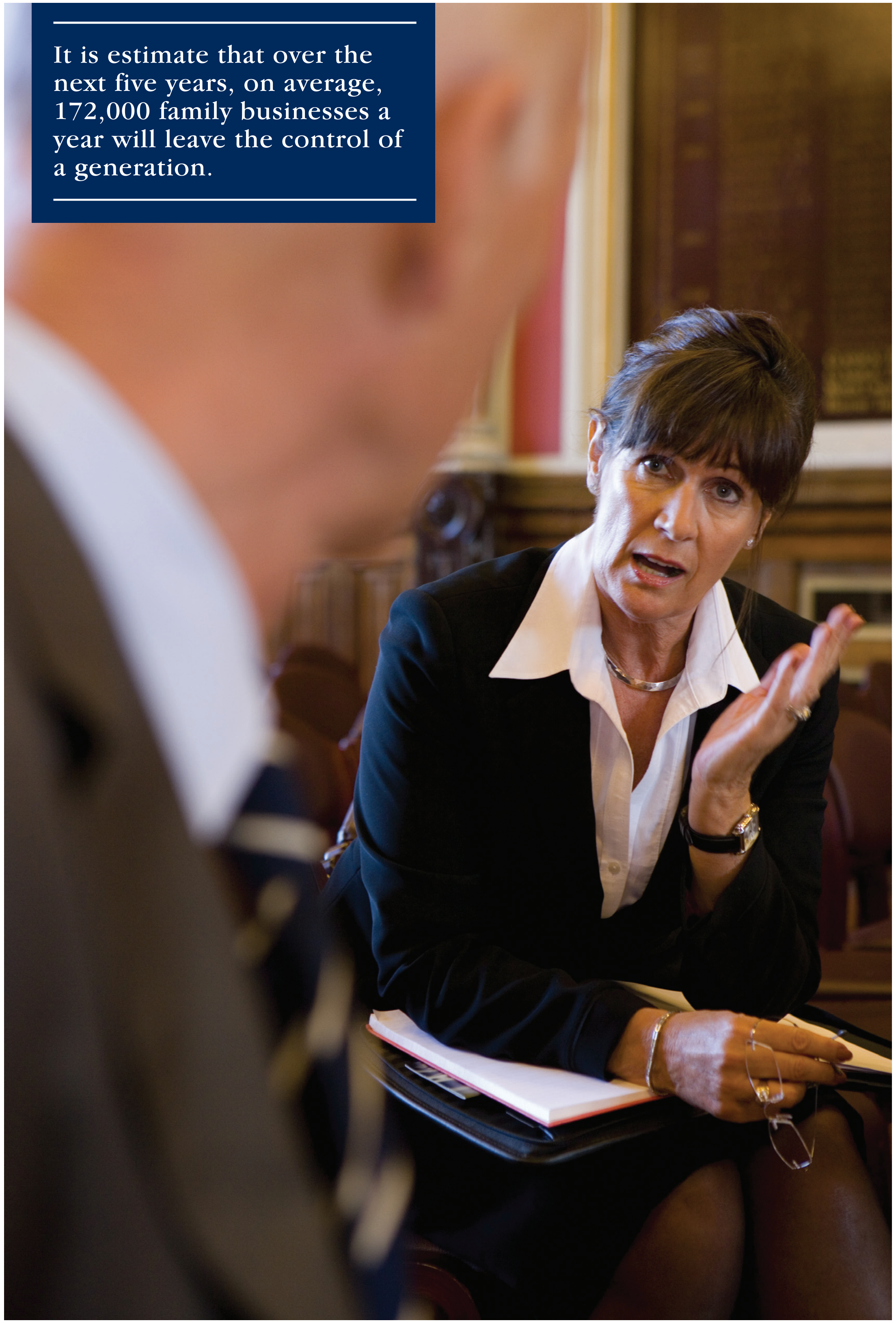
Another potentially troublesome, stressful but wholly predictable scenario concerns family members working in the business but underperforming. How is the family going to deal with this? Can the individual be reprimanded, demoted or even sacked?

Similarly, for a whole range of reasons, previously committed family shareholders may want, or need, to sell their shares. But unless the business has a stock exchange listing there will be no ready market. Difficult questions arise, including the importance of keeping the balance of shares between family branches, whether other family members can afford to purchase the shares, or whether the company could buy them back, and what is the fair value of unquoted shares, especially if they represent a minority interest in the company and are subject to a significant discount?

And what of divorce and remarriage? Say a shareholder working in the family company is divorced and remarries. There were two children by the first marriage and two by the second. So, as well as the potential for conflict between ex-spouse and new spouse, tensions may play out between the two sets of half brothers and half sisters, likely to have grown up hearing very different accounts of the family history and being quite disparate in ages.

There are approximately 3 million family businesses in the UK, or two in three of all private sector firms.

It is estimate that over the next five years, on average, 172,000 family businesses a year will leave the control of a generation.



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UK family businesses provide in excess of 9.2 million jobs, 40% of total private sector employment, or two in five private sector jobs. To place this in context, this is around 50% more than the entire UK public sector and makes family firms the largest source of employment in the private sector.

Issues like this may seem rather abstract and unimportant in the early days of a family business, as it's propelled along by shared excitement, adrenalin and a vista of apparently limitless opportunities; but these or other potentially explosive family issues will certainly turn up at some stage as the company grows.

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During the early "age of innocence" in the family business life cycle it's possible, quietly and calmly, to lay down ground rules about tomorrow's predictable problems before they become personal to any one individual or group – at a time when they remain interesting, theoretical conundrums, as opposed to their later incarnation as very real, awkward, emotionally charged and potentially disastrous problems.

Key strategies and guidelines

Encouraging a forum for open communication on these issues and allowing everyone to put forward their views is essential. A good starting point is education – teaching the family about the challenges of ownership and learning from the experiences of other families. Some family members will feel uncomfortable discussing sensitive issues, so it's important to ensure that everyone is well prepared (agree agendas in advance) and aware of the potential challenges that lie ahead.

Try to make sure that no-one feels defensive and that family members are allowed to express their views without interruption, while providing a framework for subsequent questions and debate. Urge everyone to focus on the future rather than the past, and to make the most of this golden opportunity to put in place sensible policies to govern how the family will manage future, potentially divisive, issues. Encourage everyone to think about "what-if?" questions on topics like:

- *Family jobs:* What should be the criteria for working in the business? Should in-laws be allowed to join? What if family members do not perform to appropriate standards? What rules should govern management succession and selecting the next leader? When should family members retire? You know that all these questions are going to come up at some point, so it's much better to tackle them in principle and in advance.

- *Family communication and decision making:* As the family tree grows, communication becomes more important, and more difficult. Similarly with decision making – how do you agree, and what happens if you don't agree? How should conflict be managed? It's much, much easier to formulate policies and rules for such potentially stressful situations before they arise.

- *Acquiring ownership:* Who is entitled to own shares? What about spouses? What about stepchildren or adopted children? Everybody will have a different view, but you're better off deciding on a policy before any family members think about passing shares outside the family.

- *Selling shares:* Set the rules on shareholders exiting at a time when nobody wants to sell – before anyone knows the value of the shares or whether they're a buyer or a seller. At this early point, discussions can be non-confrontational and non-personal, and it's in everyone's best interests to arrive at a fair process.

Get it down in writing

Writing down your family's conclusions on all these issues is essential. It could be in a full-blown family constitution, or in a less formal memorandum of understanding, and some of it (especially ownership issues) might best be included in a shareholders' agreement. The format doesn't really matter, as long as everyone feels they have been consulted and decisions are recorded in writing – this helps to avoid the problem of "selective amnesia" (a family business trait!) and also allows the family to revisit, review and update what should amount to a "living" rulebook.

Families can never expect to predict every single risk in advance, but working in this organised way on those risks that are predictable prepares them to cope better when the unexpected happens. More importantly, looking ahead in this way – working together to assess risks, agree strategies and devise governance mechanisms – improves communication, builds trust, helps the family to manage everyone's expectations, and lays excellent foundations for family cohesiveness and business sustainability.