

# You can't take Family out of Family Business

Stanley House, 22<sup>nd</sup> April 2009



forbessolicitors.

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## Family Businesses – Introduction

Jim Akrill  
Corporate Finance



- chartered accountants
- corporate finance
- technologies
- wealth management

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### WHAT IS A FAMILY BUSINESS



“Where 2 or more extended family members influence the direction of the business through the exercise of kinship ties, management roles or ownership rights”

(Harvard Business School)

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- wealth management

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## THE EXTENT OF FAMILY BUSINESS



- 3.5 million businesses registered in the UK
- 60% of all businesses with a turnover of up to £5 million are family firms
- Only 1 in 8 ever make it to a third generation

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## FAMILY BUSINESS SURVEY



- 72% first or second generation businesses
- 69% stated providing for family needs is a key goal
- 56% regarded the business as a retirement fund
- 41% were building a legacy for the future family
- 64% where controlling shareholder over 51
  
- 6% had a documented family agreement

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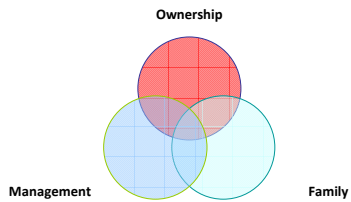
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## WHY FAMILY BUSINESSES ARE DIFFERENT



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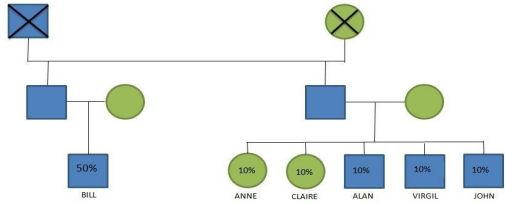
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## SUCCESSION PLANNING vs SALE PLANNING



ABC ENGINEERING LTD



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## TOWARDS A FAMILY CHARTER



- Family vision statement
- Family values
- Management philosophy
- Family jobs and remuneration
- Leadership
- Share ownership
- Composition of the board of directors
- Conflict resolution measures
- Training and education of succeeding generations

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## Family Businesses – Structures and Succession

Daniel Milnes  
Business Law



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## Family Business Structures

- What to consider in structuring a family business
  - Ownership
  - Management
  - Contributions
  - Risk and Liabilities
  - Lifestyle Business?
  - Exit
  - Succession



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## Family Business Structures

- What vehicle could the business use
  - Sole Practitioner/ Trader
  - Partnerships
  - Limited Liability Partnerships
  - Limited Company (CLS or CLG, CIC?)
- How to choose
- Same structuring issues
- Different solution depending on the vehicle



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## Family Business Structures

- Elements in a structure
  - Background Law
  - Constitutional Documents
  - Ownership Agreements
  - Employment Contracts
  - Wills
  - Trusts



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## Family Business Structures

- Issues to Address
- Ownership v Management
  - e.g. Shareholders v Directors
  - Not all decisions are equal
  - Strategic v Operational
- Not All Owners Are Equal
  - Share Classes
  - Equity Partners
  - Designated Members



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## Family Business Structures

- Income Planning
  - Salaries (companies)
  - Benefits (all)
  - Profit Shares (LLPs and Partnerships)
  - Drawings/Loans (all)
  - Dividends (companies)
- Tax advice essential
- Flexibility



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## Succession

- Succession in the simplest form
- Intestacy – what happens if you do nothing?
  - No control
  - Circumstances may change
  - Unwanted in-laws
  - Inheritance (Provision for Family and Dependents) Act 1975



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## Succession

- Making a will – good plan anyway
- Consider:
  - What are you trying to leave?
  - Who pays tax on it?
  - What about the constitution?
  - Is there an Ownership Agreement?
- Co-ordinating multiple wills
  - Can't make assumptions
  - Contracts are better in that case



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## Succession

- Ownership Agreements
- Trigger Events and Consequences
- Trigger Events:
  - Death (or serious ill-health)
  - Retirement
  - Termination of Employment/Partnership
  - Flotation?
  - Sale of Business
  - Personal Insolvency?
  - Divorce?



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## Succession

- Consequences in Companies
  - Offer to Sell Shares
  - Pre Emption / First Refusal / Right to Match
- Consequences in Partnerships
  - Exit
  - Demotion
- Valuation and Payment
  - Good Leavers and Bad Leavers?
  - Formula or FMV?
  - Payment Schedule?



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## Succession

- Buy-Backs
  - Business's assets used to make pay out
  - Default solution in a partnership or LLP
  - Can happen in a company by choice
  - Can be written into an Ownership Agreement or Constitution
  - Watch out for background law



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## Succession

- Management Buy-Outs and the like
  - New owners pay to remove the old
  - A "sell" not a "give"
  - Could be by share option
  - Partnership deals: "one in, one out"
  - Often not predetermined
  - Mix of family and others



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## Succession

- Management Buy-Out Issues
  - Strained relationships
  - Distraction
  - Funding and Deferral
  - Price
  - Warranties and Indemnities
  - Continued involvement?



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# Family Businesses – Employment Issues

Peter Byrne  
Partner and Head of Employment Law



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# Family Members

- Different levels of family involvement
  - Owners / Shareholders
  - Employees
  - Creditors
  - Relatives of any of above
  - Retired family members still with influence
  - Potential successors
- All are Stakeholders



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# Business Types

- Sole Practitioners/ Traders
- Partnerships
- Limited Liability Partnerships
- Limited Companies



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## Employing Family Members

- Advantages
  - Extra motivation
  - Commitment
  - Loyalty
  - Flexibility
- Disadvantages
  - Perception of non family employees
  - Preferential treatment not fair or deserved



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## Status

- Which hat are you wearing today?
  - Principal/sole trader
  - Partner
  - Shareholder
  - Company officer/director
  - LLP Member
  - Employee
- Regularly wearing more than one hat at the same time



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## Making it work

- Communication
  - All stakeholders to understand the business strategy
  - Structure
  - Clients
  - Future vision and direction
- Regular family forums
- Discuss personal, business and family aspirations



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## Making it work

- Communication continued
  - Include employees who want to succeed to the business
  - Involve trusted employees in strategy
  - Non-family shareholders
    - Written
    - Meetings
- Away days with existing management team if introducing family member



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## Making it work

- Communication continued
- Fully discuss dynamics of workplace relationships
- Encourage open discussion of issues
- Involve others early in the process
- Reward all fairly to avoid animosity



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## Ownership/Management

- Discuss existing ownership and management structure
- Discuss potential future developments
- Need to retain control/ obtain dividends
- Balance with needs of others
- Consider need for external capital
  - How is this to be achieved while retaining protection for family members



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## Ownership/Management

- Decide what will happen to shares if:-
  - Family member leaves the business
  - Dies
  - Divorces and his/her spouse holds shares
  - Does the business want them back to keep control
  - Succession planning upon retirement
  - Disaster continuity plan



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## Ownership/Management

- Family succession
  - Plan and agree your approach with family and key employees
  - Plan gradual handover to accommodate a different management style
  - Reduces risk of shock and fallout from sudden change
- Is a sale ultimately contemplated?



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## Employment Issues

- Fairness in Employment Issues
  - Agree an approach re recruitment of family members
  - Fair and objective appraisal system
  - Reward and promote effectively
  - Capability issues to be dealt with promptly
  - Ignore dividends when considering terms
  - Dividend policy?



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## Employment Issues

- Have senior positions held by a mixture of both family and non-family members
- Ensure transparency by not giving family members overtly preferential treatment
- Performance related pay and benefits strongly recommended
- **CONTRACTS**



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## Employment Issues

- Employing your spouse/partner
- Seek professional advice on issues
  - Type of role
  - Terms and conditions
  - Keep record of work done
  - Pension get tax advice re benefits, sharing profits etc
- Always consider what happens if the wheel comes off!



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## Employment Issues

- May need to address employment status in conjunction with other roles
  - Directorships
  - Shareholders



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## Family members

- Remember that 60% of UK businesses are family owned
  - i.e. one family owns more than half the voting shares – Source Business Link
  - Problems you encounter have already been experienced by others
  - Take advice



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## Family Businesses – Financial Considerations

Tony Brierley  
Wealth Management



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## CONTINUE BUSINESS ISSUES



- Profit extraction
- Pensions
- Retirement planning
- Valuations
- Non-executive directors
- Shareholder protection
- Key person insurance

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**PROFIT EXTRACTION**



- Sole trader, partnership, LLP, Ltd Co
- Salary v. dividend
- Company cars

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**PENSIONS**



- Tax relief on contributions
- Tax free growth in fund
- Tax free cash on vesting
- Phased retirement
- Investment control
- Property purchase
- Loans to sponsoring employer

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**RETIREMENT PLANNING**



- Plan
- Assess cost of lifestyle
- Lifetime cash flow

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**VALUATION**



- Arms length?
- Funding
- Company buy back of shares
- Deferred consideration

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**PROTECTION**



- Shareholder protection
- Key person

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**SALE OF BUSINESS ISSUES**



- Capital Gains Tax
- Inheritance Tax
- Investment of proceeds
- Generate replacement income

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## CAPITAL GAINS TAX



- Taper relief
- Entrepreneurs relief
  - 6 April 2008
  - Max £1m
  - 4/9ths of 18%
  - Sole trader, partner, shareholder
  - 5% share capital
  - Director for 12 months

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## INHERITANCE TAX



- Business property relief
- Agricultural property relief
- 2 year qualification

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## CONCLUSION



- Questions and answers

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