THE TAX INSTITUTE

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Threats to Family Business

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1.Overview

All businesses, no matter what size or structure, or the industry sector they are engaged in, are continuously presented with opportunities and often confronted by threats. These opportunities and threats are most commonly analysed by reference to the effect that they will have on the financial position of the business.

When professional service advisors are engaged to assist a business, whether that be as part of the ongoing conduct of the business, or to work through a particular opportunity or threat, they bring to the business their experience and skill. When engaging an advisor, businesses typically seek to engage a person with skill and experience in the area in question. However, only rarely will a family business actually seek out a specialist family business advisor. Professional services to family businesses have traditionally been provided without regard to how the dynamics, structures, goals and constraints of a family business differ from non - family business.

Family business plays an important role in Australia's economy and workforce, however its diversity, size and lack of easy definition hinders recognition of family business as a separate business sector, and especially as a sector which is deserving or requiring specialist advisory skills.

There is a link between being a family member, asset ownership, expectation of employment and expectation of an inheritance within a family business that does not arise in other business structures. This linkage means that the potential threat of such things as relationship breakdown or bankruptcy of a family member can have far greater ramifications for a family business than arise in a typical employment situation. Also, the threat of conflict between family members can have significant consequences for the business. Conflict can have many sources in a family business, often not related in any way to the business. Such things as sibling rivalry, developed over many years and often latent or at least not acknowledged as such, can cause conflict which overflows into the workplace.

Family business has historically not been known for its focus on succession and intergenerational change, and where such issues are not addressed within a family, it can present as a threat to the business.

The question could be posed - is a successful family in business one that amasses great wealth, power and status, or one that has more to do with the state of the family and the quality of the relationships between its members? Most advisors would enter into an engagement on the basis that the former proposition is the goal of the family, without seeking to analyse whether the second is of primary importance, or at least of equal importance to the family, or a significant proportion of it.

What this paper addresses is why, when consulting to family businesses, a skilled advisor will consider engaging a different style of consulting and analysis of situations which recognises and is based on the unique characteristics of a family business. The paper will outline issues which make family businesses different, what are the things that drive successful family businesses or mean that some family businesses are less successful than others and provide an explanation of some of the current perceived best practices in family business consulting.

2. The importance of family business to the Australian economy and statistics about families in business

The importance of family business to the Australian economy is perhaps best borne out by statistics. However, these statistics also tell a different story which is the uncertainty that pervades family business.

These statistics are derived from a number of sources, including the KPMG and Family Business Australia Family Business Surveys 2013, 2015 and 2018 and MGI Australia Family and Private Business Survey.

1. Family businesses constitute approximately 72% of all businesses in Australia.
2. Family businesses generate 50% of gross domestic product.
3. Family businesses employ around 50% of the total workforce in Australia.
4. The average number of employees in a family business in Australia is 23.
5. 98% of family businesses employ less than 200 people (75% have less than 20 employees and 23% have 20 to 199 employees).
6. The average age of a family business owner is 58 and 25% of owners of family businesses are aged over 65.
7. Many family businesses survive for generations and the average length of time family businesses have been operating in Australia is 34 years.
8. 26% of family businesses are in a second generation of ownership and 14% are in a third generation or more.
9. 63% of family businesses had a leadership transition strategy in mind, but 29% had no management transition strategy and 32% had no ownership transaction strategy.
10. 82% of family businesses have no agreed or documented family charter, constitution or code of conduct.
11. Family businesses are pessimistic about succession with 41% considering it would not be feasible to have a formal succession plan.
12. 37% of family business owners report that letting go of leadership and control is one of the most critical issues facing their business.
13. The average tenure of a CEO in a family business in Australia is 17 years.
14. 36% of family businesses have only one generation involved in the business, 59% have two generations involved and 5% of family businesses have three or more generations involved in the business.
15. 48% of family businesses have a formal board.

16. 10% of family businesses are owned by females and only 9% of daughters are actively involved in the business compared with 35% of sons. 15% of family businesses have female CEOs.

17. 18% of businesses are planning some form of leadership transference within the next 12 months (53% of whom intended to pass leadership onto a non-family member), 54% within the next two to four years, and 28% in five or more years.

18. For businesses who planned a transfer of ownership within the next five years, 74% of those surveyed did not know who ownership would pass to.

19. 40% of incumbent business leaders did not believe their potential successor was ready to take control of the business, and 64% of these potential successors did not believe they were ready to take over the business.

20. 10% of family business leaders intend to sell the business in the next 10 years.

21. 61% of family business owners would seriously consider selling if approached.

22. 70% of family businesses are very or extremely concerned about the increasing cost of doing business.

23. Family businesses see the top five threats to future growth as being:

    1. increasing costs of doing business;
    2. increasing tax burden;
    3. government response to the current economic conditions;
    4. government response to growing fiscal deficit; and
    5. over regulation.

24. Over 80% of family businesses indicated they had experienced conflict or tension between family members over the last 12 months with the primary sources of conflict being:

    1. vision, goals and strategy;
    2. balancing the needs of the family against the business;
    3. lack of family communication;
    4. family related succession;
    5. financial stress;
    6. managing growth;
    7. how decisions are made;
    8. competence of family in the business;
    9. lack of family/non-family communication;
    10. remuneration; and
    11. sibling rivalry.

3. Understanding the family business paradox.

A manager occupying a senior position in a business is tasked with ensuring the sustainability of the business in a competitive marketplace, juggling staff performance, financial performance, return on investment for shareholders and other such issues all with the underlying goal of meeting performance criteria. An advisor called upon to assist in these areas is working in familiar territory, as these roles are well understood.

However, many other issues arise for a family in business.

For example, when the owners of a family business consult a lawyer in relation to business or personal succession, there may be many other issues which are of fundamental importance to them, but which lawyers frequently overlook or are not made aware of in obtaining instructions from their client when providing advice. Issues which may be relevant to a family, which are not relevant to a non-family for profit business include:

- providing financial security for all members of the family, especially older members moving into retirement;
- family cohesion, ability and loyalty;
- nurturing and protection of those less fortunate and able;
- building and protecting the family's legacy;
- ensuring the family business remains competitive in the marketplace with a particular potential focus on family conflict arising where the older management/owner generation do not see the need for change;
- the balance between personal and family needs, interests and objectives with those of the business;
- a perceived obligation to provide employment to all family members.

In summary therefore, a family business involves a complex web, where the personalities, history, capabilities, attitudes, motivations and values of a range of individuals all intermingle and are an integral part of the family and their business, and as such are present in the minds of those providing instructions in relation to family business succession, but not all of these are brought to the table in discussion with advisors.

Consulting in the family business space requires an understanding of these issues and the development of emotional intelligence by the advisor of a far different nature to that which is brought to bear in most consulting engagements. In many cases, technical expertise and a correct solution for the business may need to make way for a human focus and the provision of a solution which suits the needs and desires of the family, more than the needs of the business. As such, technical skills need to be balanced with human skills.

There are a number of examples which can be given to demonstrate the above circumstances in practice.

One issue of concern to professionals is often who is the client? Depending upon the nature of the engagement, and in particular where there is already conflict, or there is the potential for conflict, this can become an important question. However, the position frequently arises that whilst there is an initial or main point of contact within the family (and this may not necessarily be the same person), contacts and level of confidence change over time, bills are paid by the business and contact becomes multifaceted with instructions provided by numerous people and confidences are shared by many. For a lawyer, the possibility of a conflict of interest is obvious.

Meeting with representatives of the family can throw up a number of potential conflicting scenarios. Advising in this area requires the gaining of an understanding of the family and the roles of the people in it, which involves not only an understanding of the individuals, but how they work within the family and within the business. It requires an understanding of the personalities, the unwritten rules which have developed within the family in the business, how the members of the family work together as a team, and importantly how all this is overlaid by the history and tradition of the family and its business. Unexpected problems can arise. For example, a family may operate on the basis that its role is to provide employment for all family members. However, this of itself can give rise to conflict, because some within the business believe that others do not contribute to the same level but receive acknowledgement, including by way of remuneration, above that which they can achieve elsewhere.

Another example comes from family members who are not involved in the business. Those persons can often form opinions about the business or the people involved in it and importantly how they are being treated, without fully understanding all of the issues. Often this can come about because of a sense of loyalty to family members, or a belief that things within the business are operating as they always have been, with for example, the patriarch or matriarch playing a dominant role, whereas in fact real leadership of the business may have passed to the next generation. This can be amplified by many families having a deep sense of attachment to and pride in the business which has been an important part of the family member’s life since childhood, particular where the business carries the family name.

Another example where special consideration must be given in consulting to a family business, is the stage in the business cycle which the business occupies. There are three dimensions to this understanding, whereas consulting to a non-family business frequently only provides one dimension. The first and obvious is the business dimension, which involves analysis of whether the business is a start-up, in a growth phase, has reached maturity, is in renewal or should be in renewal.

The second dimension is the ownership dimension, which requires an analysis of whether the business is still under founder control, is there a sibling or other partnership, is there what is known as a cousin consortium, and are their owners not actively involved in the business whose needs or wishes must be considered.

The third and final dimension is the family dimension. This involves an analysis of the stage of life the owners of the business are in and also that of the other family members who are involved in the business - do they have a young family, are members looking to enter into the business, what are the capabilities of the business to consume more family as employees on a basis which will maintain the profitability of the business, what is the ability of the family members to work together, and what are the abilities of the family members to contribute to the business? When, how and on what basis should the baton be passed to other leaders, and what process is in place to support all family members and the business through this change with a particular focus on both the incoming and outgoing managers?

The above can all be described as the family business paradox which is the conflict between business principles, practices, values and goals compared with those of a family in business.

This paradox is often presented in a number of ways.

The most common is what is called the three circle model. A family business is viewed as being comprised of three separate overlapping systems. The business system encompasses the organisation's mission and strategy. It also includes the various elements that support the business strategy, such as the organisation structure, systems and technology, along with the key processes that help the organisation achieve its goals.

The ownership or governance system includes the organisation's legal form, such as a discretionary trust, company or unit trust, the distribution of its ownership, the Board of Directors or other governance mechanisms and the goals and aspirations of those who govern the business.

The final system is the family system which includes the family and its connections both with each other and with the organisation. The family's goals and aspirations, its roles and relationships, its communication patterns and its cultural values are all part of the family system.

When put together, within the three systems/circles, the various responsible personnel are therefore:

- non-family owners/investors;
- family;
- non-family managers/employees;
- inactive family owners;
- owners/managers;
- family employees;
- family owner/manager.

The unique features of a family business arise as these systems overlap one another. Importantly, the issues which many family businesses face arise because of, or as a result of, attempts to manage these three systems without acknowledging or even understanding the differing values which families bring to businesses. These differences can best be seen when the difference between the family system and a business system is analysed against certain key issues which arise in a business.

	Family System	Business System
Goals	Development and support family members	Profits, revenues, efficiency, growth
Relations	Deeply personal or of primary importance	Semi-personal or impersonal, of secondary importance
Rules	Informal expectations	Written and formal rules, often with rewards and punishments spelt out
Evaluation	Family members rewarded for who they are, effort counts, unconditional love and support	Support conditional on performance and results, employees can be promoted or fired

Succession	Caused by death, divorce or illness	Caused by retirement, promotion or departure
Authority	Based on family position or seniority, or the person who was employed first in the business	Based on formal position in the organisation's hierarchy
Commitment	Intergenerational and lifetime based on one's identity with the family	Short term, based on awards received for employment

4. "Family and business ain't natural…."

Another way of depicting the difference between the family system and a business system, and therefore the fundamental paradox within a family business has been given by the Family Business Institute under the heading "Family + Business ain't natural …"

Business system	Family system
Rational	Emotional
Compete	Protect
Disciplined	Hierarchical
Task-based	Obligation based
Performance	Expectations
Competencies	Connections
Results orientated	Relationship orientated
Outward relating	Inward relating
Merit and contribution	Status by birthright
Strongest survive and thrive	Weakest get nurture and support
Growth: learn, adapt and change	Entrenched: maintain status quo
Employment is an opportunity	Employment is an entitlement

5.Business values

It is usual as part of the strategic planning for a business to analyse and capture the values which drive the business. Research has shown that family values often do not change over time, but when management changes in a business that is not a family business, values driving the business change. It has also been identified that values which a family embraces in its business tend to be personal values which have an intuitive quality, and as such are difficult to measure. The values which are more readily attributable to a business tend to be transactional in nature and can more readily be measured.

Values in the table below which are said to be family first values have been shown to comprise 70% of the values which are adopted by family businesses with family businesses only adopting 30% of those values which are said to be business first values. Conversely, non-family businesses have 70% of their values from the business first column, and only 30% from the family first list.

Business first values	Family first values
Innovation	Courage
Empowerment	Dignity
Teamwork	Fairness
Performance	Honesty
Integrity	Open-mindedness
Leadership	Authenticity
Efficiency	Hard work
Profitability	Stewardship
Honesty	Dependability
Communication	Empathy
Creativity	Curiosity
Learning	Humility
Continuous improvement	Discipline
Entrepreneurship	Prudence
Excellence	Sincerity
Customer service	Do the right thing
Change	Integrity
Quality	Reputation

Within this framework, the most common family business values can be grouped under the following headings:

1. Mutual respect - empathy, tolerance, compassion, trust, generosity, cherished individuality.

2. Stewardship - perseverance, long-term, determination, tenacity, persistence, hard work, legacy.

3. Integrity - do the right thing, honourable, trustworthy, reputation.
4. Personal responsibility - independent thinking, reliability, freedom.
5. Fun - enthusiasm, passion, celebration.

6. The characteristics of family business - performing and non-performing

A family business often focuses significantly on the past, little on the present and much in the future. A non-family business frequently ignores the past, focuses a lot on the present and moderately on the future. As such, the key focus is reversed between family and non-family businesses.

Successful family businesses typically show the following characteristics or capabilities:

- thinking long term;
- sensing opportunities;
- managing paradoxes;
- assessing risks;
- alliancing;
- building social capital;
- retaining corporate memory and regard for history (stewardship/legacy);
- building owner-manager-board relations;
- thinking options; and
- managing succession.

To build towards success, high performing family businesses display a number of fundamental human dynamics:

1. awareness - not only about the current state of the business, but also awareness that the family has or intends to become a long time family in business with obligations and responsibilities as well as benefits and rewards;
2. a will to act - the readiness to implement and maintain best practice strategy, structure and systems;
3. capacity - the family has the knowledge skills resources and time to confront challenges;
4. commitment - the ability to commit financial and emotional resources and holding people accountable; and
5. stamina - establishing and maintaining strategies, structures and systems over the long term.

Successful family businesses also seem to adopt a number of key strategies to achieve and ensure continuing growth and financial success. Those strategies include:

1. Developing and living a stewardship culture

A commitment to hold, nurture, enhance and pass the family's business interests to the next and future generations rather than allowing the current generation to spend at the expense of the future.

2. Creating a shared family vision and a shared sense of purpose

Determining why the family is in business and how they intend to conduct the business, determining who they stand for as a family and as a family in business and understanding the distinction between driving the business for short-term benefits for themselves or long-term benefits for the family and balancing these issues to derive reasonable returns for the current incumbents but retain sufficient to provide support, benefits and opportunities for future generations.

3. Being proactive and planning for the future

Planning for both the business and the family and communicating those plans, particularly to those expected to follow and support. The plan for the family should look to them being happy, involved and supported.

4. Communicate

Having structured family and business meetings and ensuring all participants have appropriate training and modelling of communication skills.

5. Resolve conflicts

Address potential problems and conflict without prevarication, ensuring those tasked with the job of effecting the resolution have the appropriate skills and training.

6. Separate the business from the family

Adopt family constitutions and have a Board of Directors for the business and a Board of Directors for the family (a family council).

7. Separate ownership from management of the business
8. Balance - work both on the business and in the business with an appropriate balance between the two
9. Balance - work for the family and with the family
10. Balance – having “me” time
11. Have a family constitution which includes policies, values and rules of engagement
12. Parent well (teach/support/respect) at home and in the business and in particular strive to not have competition between family members

Similarly, lower performing family businesses tend to display a series of similar characteristics which include:

1. disparate family owners have widely different goals and risk preferences intensifying conflict;
2. family owners are too easy on management due to nepotism or altruism;
3. nepotism leads to adverse selection of less talented managers;
4. significant personal wealth and ease of security lessens management discipline;
5. failure to attract non-family management in particular because of a failure to provide opportunity to advance;
6. family members stuck in traditions that block new insights and change;

7. dysfunctional family culture creates paternalism and corruption;
8. family conflicts chase away best managers;
9. family fails to expand its networks;
10. family doesn't trust outsiders and depends on easy to control executives; and
11. family under invests in businesses potential - low debt, high personal consumption.

7. The 12 simple secrets of success in family business

The Family Business Institute has developed a summary of 12 elements which produce success in family businesses:

1. Create a family plan
2. Share the family's visions and goals
3. Create a stewardship culture
4. Resolve issues, problems and conflicts
5. Communicate COMMUNICATE **COMMUNICATE**
6. Separate family from business decision-making
7. Separate ownership, leadership and management
8. Work on the business and in the business
9. Work for the family and with the family (be present)
10. Sustainable families need rules and discipline
11. Insist on accountability – execute or **execute**
12. Succession is a process - it is not an if, but a when

The earlier parts of this paper outline what makes family business different and why as advisors it is essential to be mindful of and seek to understand the different environment a family business operates in when compared to non-family business – as it is only then that advisors will achieve the best outcomes for the family and the business.

The balance of the paper will provide an outline of the types of things that successful families and their advisors are doing to achieve and maintain their success – both as a business and as a family.

8. Best Practice – what are the successful families in business doing

8.1. Communication and education

The most readily identifiable threat to a family in business is conflict within the family. For many families, the conflict is often only acknowledged and advice sought way after a time when skilled advisors could have assisted the family in overcoming the problem. Engaging lawyers to provide advice in relation to this type of conflict, unless that lawyer operates within the paradigms described within this paper, with an understanding of the special characteristics of family business, can often only make matters worse, with the ultimate worst case scenario being the issue of court proceedings.

Best practice indicates that where a family engages in the ethos of family business and seeks to engage in best practice, disputation is more readily dealt with within and by the family. In this sense, education about family business best practice, and some form of implementation of best practice strategies, means that disputes are less likely to occur.

Communication between family members which is effective, open and constructive is seen as being fundamental to maintaining both a successful family, a successful business and a successful business family. Most of the best practice recommendations outlined in this paper are founded on the concept of communication and engagement.

Best practice suggests that an open dialogue, including in relation to such things as succession plans for the business, is essential for the family to continue to work together in the best interests of the business and the family. This also allows those family members who are not actively engaged in the business to understand what role they might have in it in the future, or importantly, whether they have any grounds to believe that there will be an inheritance which includes some form of engagement or ownership in the business, or where there is no such opportunity, what other arrangements the family has made for the time post the death of their parents or other parties involved within the business. Whilst engagement to this level will not necessarily avoid conflict, it does mean that it can be addressed at a time when all family members have the benefit of the then current patriarch or matriarch of the family business to assist in addressing issues which might arise.

8.2. Identifying and managing conflict including sibling rivalry

8.2.1. Causes of Conflict

There has been a great deal of research in relation to causes of conflict within a family and family business. Those causes can be divided into three main themes being family issues, business issues and people issues.

Family issues include such things as family values, ethnicity, parenting and related emotional baggage, relationship problems, sibling rivalry, nurture v independence, ownership contrasted with stewardship and the transferring, buying and selling of interests in the business.

The business issues which are the most common causes of conflict primarily relate to financial, ownership and employment matters, including such things as the entwining of ownership, leadership and management, the sometimes contrasting financial needs of a family and the business, employment of family members and their performance and remuneration, the need for succession within the business, the need for the business and its processes to be modernised and dealing with non-family managers.

The final causes of conflict brought together under the heading of people issues, stem from human and personality diversity, culture and tradition, in-laws, divorce, the emotional dynamics of a leader and how he or she can be replaced.

In a family business, conflict can be long seated, based on historical issues not in any way related to the business. It is often not identified as conflict, being characterised as “normal sibling rivalry”, and allowed to fester as such.

Earlier in the paper, when outlining the family business paradox, I noted that family conflict often emanates from family members who are not involved in the business. These people often were raised sitting around the kitchen table where the primary focus of conversation was about the business. With no ongoing involvement in the family business, there is a trend for these people to continue to see the business as it was when they were children, and particularly tend to see things through their parents eyes, just as they did when they were children, without an understanding of the then current dynamics within the business and how the next generation, usually their siblings, have assumed control of the operations of the business. When such persons become engaged in a dispute, it can often exacerbate conflict.

The end game of any family conflict is usually that those in conflict still remain engaged in both the business and the family. This is not an outcome found in the case of conflict between employees of non-family businesses. Such things as understanding sibling rivalry, dealing with the disappointment of not being advanced within the business, pay differentials and perceived parental favouritism are all grounds for conflict within a family business. In non-family businesses, such issues are solved by the affected party or parties moving on. In family businesses, this frequently does not incur and in fact the broader family frequently actively works against family members leaving the business.

8.2.2. Dealing with disputes

Whilst processes of dealing with disputes can be incorporated within governance mechanisms, such as a family constitution, there are some steps which a family can take, which go beyond the normal provisions within a governance agreement.

The usual grievance processes are of course mediation and arbitration, which can be incorporated into a family’s processes by agreement through a family council and constitution.

Outside the bounds of a family council and family constitution, more and more families are looking to have some form of psychometric testing undertaken of all key family members, the reports of which are fed back to the family to assist them in understanding the key drivers of those tested. The extent of the testing and the parties to whom reporting is made always needs to be considered. For example, should reporting and feedback be limited to the owners of the business, or involve all family members engaged in the business, or all family members, and should it include spouses of family members, given the effect that their attitudes and perceptions have on family members.

The extent to which families then utilise the results of this testing is of significant importance. Properly utilised, these tests give the participants a detailed insight into the personalities of the people involved, and with appropriate guidance, the reporting and feedback better informs the family about how they can work together to reach decisions and the processes which should be adopted to achieve this.

There are a number of families which now routinely engage with a psychologist as part of their family governance and family and personal wellness and education strategies.

This type of assistance can help not only the family members who are involved in the conflict, but also those around them to understand and cope with their feelings, and hopefully obtain insight in relation to personal strengths and weaknesses both in the business and family areas.

There are of course many different types of testing which can be undertaken, some of which is both complicated and costly. However, assisting people to understand their personal drivers can bring a marked difference to the person tested's performance, input and understanding of others. I have worked with one business where the business principal carries round cards reminding him of the key characteristics of his clients and the people within the business divided into four categories:

1. the minders who are motivated by security and won't say anything to rock the boat;
2. the organisers who are motivated by procedures and like getting things right;
3. the directors who are motivated by power and control who everybody else hears as they go racing by; and
4. the enthusiasts who are motivated by recognition and love having fun.

This high performing individual often refers to the cards to assist him to develop strategies for dealing with people in contractual negotiations, or internally to prepare for having those difficult discussions in relation to performance which from time to time he has to have with employees.

8.3. Family Law Act - binding financial agreements

The threat of family breakdown for a child or sibling remains one of the greatest fears of a family in business. It can of course create a significant threat to the business in a number of ways. First, there is the financial stress with families having to assist a family member financially through a separation, including to fund a settlement relating to the division of matrimonial property. Secondly, there is the psychological stress which the family member will be undergoing, and there is of course always the possibility that the performance in the business of the individual concerned will be adversely affected, meaning that his or her contribution to the business diminishes, which can in turn have consequences for the business.

It goes beyond the scope of this paper to analyse the legalities behind a binding financial agreement (the so-called prenuptial agreement) under the Family Law Act, but the benefits of such agreements are obvious. There remains concern amongst some in the legal profession about the status of such agreements. However, the law continues to be that validly entered into, such agreements remain of legal force and effect.

Therefore, any advisor consulting to a family in business, should raise the possibility of family members entering into binding financial agreements as a matter of course when they enter into relationships. Some families now have it as an essential component of the family constitution that all family members entering into any form of domestic relationship, of course of which marriage is only one component, enter into a binding financial agreement. One benefit of having such a provision is that it makes the discussion with a partner or prospective spouse much easier, because it can be made clear that it is a requirement of the family, not of the individual family member concerned.

Another issue to bear in mind in relation to both a binding financial agreement, and risks which arise from the breakdown of the relationship in general, is the need to consider how the family operates when a binding financial agreement is in place, or where there is a risk of relationship breakdown. Too often, families make determinations based upon taxation considerations, rather than protection of the family, and in particular the family business. Further, often the terms of the binding financial agreement are overlooked in the acquisition of assets after the agreement is entered into. An example in point would be superannuation contributions and investments made by a superannuation fund. In the case of superannuation, the focus is often placed more on the taxation considerations, rather than protection of the integrity of the binding financial agreement.

Similarly, many families make wide-ranging distributions to family members from a discretionary trust as part of their taxation planning, many of which remain unpaid. These unpaid entitlements, which may not even be disclosed to family members, are frequently not either included within the provisions of a binding financial agreement, or the potential consequences of their existence, in the event of a breakdown of the relationship, is not considered. Taxation considerations tend to drive the determination as to which parties will receive distributions, with no regard to the consequences that may flow if the distributions remain unpaid, and the recipient is subject to a marriage breakdown, or even personal insolvency.

There are also numerous cases where children who have fallen out with their family have taken action to recover an unpaid entitlement from a discretionary trust.

Similar concerns arise in relation to loans, with little distinction being given as to whether advances made are loans or gifts. Within the jurisdiction of the Family Court, it is understood the position now to be that the Court will acknowledge that the intent of parents in advancing money, is to advance the position in life of their child, and therefore there will be acknowledgement that the funds which were provided should flow back to the child whose parent made the advance in the circumstances that the relationship breaks down. More fundamentally, such issues can be overcome if the advance is documented as a loan, with or without interest, repayable on terms to be agreed.

8.4. Trust and corporate structures

Careful consideration must always be given within a family business and in structuring for the making of personal investments to the asset protection, succession, income tax and capital gains tax consequences for the family and the business of the structure adopted.

As a consequence, in structuring the business and in advising in relation to both business and personal succession, regard should always be had to:

- shareholding in any company, including a company which acts as trustee of a discretionary or unit trust;
- the position of director in a company and the exposure to risk which being a director brings;
- the position of appointor of a discretionary (family) trust; and
- the use of testamentary trusts.

These issues are not the subject of this paper, but high performing families in business always give consideration to how to structure new investments or ventures, and regularly revisit existing structures to ensure that taxation liabilities, succession and asset protection for the individuals, the family and the business are optimised.

8.5. Employment agreements

Historically, families in business did not have employment agreements with family members. Whilst it could not be said that significant inroads have been made in making employment agreements common in family business, many families are now agreeing to adopt employment agreement like obligations by incorporating them within a family constitution.

My belief is that it can be just as important to have employment agreements for family members in a family business as for employees in non-family businesses. Not only do they ensure clarity about remuneration, how that remuneration is reviewed and bonuses, provisions which should be of importance to the business and the family can be agreed.

All businesses should seek to have security from all employees by incorporating within an agreement provisions in relation to:

- confidentiality;
- protection of intellectual property;
- restraints against competition;
- performance expectations; and
- position/role descriptions.

8.6. Succession

The concept of succession within a family business takes a number of forms. There is succession caused by the death of a family member. However, with a particular focus on the family business, succession involves the handing over of control of management and/or the handing over of control of ownership.

Of itself, to analyse these differing concepts of succession and best practice within a family business would consume much of today's program, and as such goes far beyond the scope of this paper.

However, focusing on the concept of handing over control management of a business, the Family Business Institute has prepared 12 guidelines for successful succession, and it is my belief that these form a valuable guideline of what could be said to be best practice in this area. The guidelines are included within the table below:

Do's	Don'ts
Use the process to refresh and renew the business	Allow ego to overwhelm wisdom
Help the current leader to re-fire rather than retire	Hand over the reins until ready to get off the horse
Include family and business values, vision and goals in a plan	Demand 65-year-old attributes for 40-year-old candidates
Make succession a process conducted over time, not an event	Wait until it's too late and allow fossilisation to become a reality

Appoint the best person, with the appropriate skills and attitude	Demand accountability without giving responsibility and authority
Be objective and professional, to avoid being emotional and protectionist	try to clone your current leader-stand on their shoulders, not in their shoes

8.7. Effective Governance

8.7.1. Board Charters

A proper functioning board is now an important component of most families in business governance structure. The concept of board review and the distinctions between strategic and operational boards are increasingly understood concepts within a family business. The benefit of having non family members on a board is also now broadly considered, if not necessary understood by families. Studies have shown that those family businesses which are most profitable are those where there is a governance structure.

However, to ensure that the Board's contribution to the business is optimised, consideration should be given to there being a board (corporate governance) charter. Such charters have four major sections.

1. Defining governance roles - the role of the board, the role of individual directors, the role of the chairman, the role of the company secretary, the role of the CEO and the overall board structure.

2. Improving board processes - board meetings, board agendas and papers, board minutes, the board calendar and committees.

3. Key board functions - strategy formulation, service contracts, monitoring, compliance, audit risk and compliance committee, CEO evaluation and delegation of authorities.

4. Continuing improvement - board evaluation, director remuneration, director development, director selection and induction and director protection.

8.7.2. Business Advisory Committee

Some businesses, where there is a tightly held ownership group seek to obtain input from a broader range of skills than is contained within the family to aid the family business. Those persons may not wish to be directors of the company, but agreed to participate in a business advisory committee which makes recommendations to the board. Many family businesses are owned and managed by people who have only ever worked in the business, and in many cases have no external management training. Choosing appropriate members of the business advisory committee can mean that the business can draw on skills which are lacking within the family to assist the business to prosper. For example, a business may have no internal expertise in digital marketing or social media, but could see its competitors having a strong presence in these areas. Having a member of the business advisory committee who is skilled in these areas, particularly where there was direct experience in the industry in question, could prove significantly beneficial to the business. Other areas of potential weakness include accounting and finance, law, strategic planning, human resource management and IT.

8.7.3. Meeting Rules

Many families also enjoy success by adopting rules for the conduct of family meetings which cover both procedures and a code of conduct. Issues which can be covered within a code of conduct include:

- respectful communication;
- listen actively;
- commitment without distractions;
- manage conflict by dealing promptly decisively and appropriately with interpersonal issues and problems;
- require participation by all;
- accept, respect and support all decisions, move on and don't allow the meeting to get bogged down; and
- allocate responsibilities and timings in respect of decisions made.

8.7.4. Investor Agreements

Just as legal practitioners would always advise people going into business together to have some form of investor agreement (partnership agreement, shareholders agreement, unitholders agreement), consideration should always be given to the family members having an investor agreement covering all of the things which such an agreement would cover for non-related persons involved in business together. Such an agreement should incorporate provisions addressing such things as:

- governance, including the appointment of directors, holding of meetings, chairing of meetings, casting of votes and whether the chair has a casting vote;
- funding of the business including the giving of personal guarantees, funding from external sources or funding from members and what is to occur if a member is not able to contribute when a call for capital is made;
- delegations of authority, roles of family members/employees with key performance indicators;
- listing of issues requiring determination at board or shareholder level and the type of authority required for resolutions to be passed (unanimous, special or ordinary resolution);
- specific provisions relating to employment, including retirement;
- the process for fundamental business decisions such as the sale of business or acquisition of a new business or assets;
- drag and tag provisions;
- allotment of further equity;
- transfer of equity, with consideration being given to forced divestment upon death or retirement;
- restraints; and

- protection of confidential information and intellectual property.

A simple example of the need for such agreements arises where the business is conducted by a partnership. There is the inherent difficulty which arises upon the death of a partner, as the law provides that a partnership ceases upon death. Effectively, this can mean the termination of the family business. For a family member engaged in the business, if the business is forced to cease, he or she is deprived of income earning capacity and a future in the business to which they have contributed. However, it does provide the option for a person in such circumstances to restart a business without having to acquire the assets from other family members. This can effectively deprive the estate of the deceased of the entitlement to be compensated for the goodwill in the partnership incorporating such things as intellectual property, client basis, employees and even premises, with the only entitlement being to an accounting for the tangible assets net of liabilities, incorporating such things as bank balances, stock, debtors and creditors etc.

8.8. Family Council

A family council is the body of family members who are engaged in managing the business of the family, as distinct from the family business. Family councils can involve such range of persons as the family believes is appropriate, with the major issue being the extent of engagement of those family members involved in the business and those not, and the engagement of spouses and children, and if so to what extent. Typical issues which a family council would have authority over include:

- to set the strategic vision for the family business;
- to appoint the directors and senior management team of the family business, including the role of non-family members within the governance structure;
- to oversee the non-business investments of the family;
- to supervise any family office;
- to oversee succession within the family business;
- the establishment of a regime of structured, facilitated family and/or business meetings with set agendas, rules of procedure and modelling of excellent communication skills particularly those modelled to supplement deficiencies in the family's skills;
- to provide business education opportunities and guidance to family members.

Best practice would see the family council meeting at least twice a year, with such meetings involving a period of family time not focused on the business or investments.

8.9. Family Constitution

A family constitution sets the rules for the family and the rules by which any family council operates. Issues which would be addressed in a constitution include:

- the process for adoption of the constitution;
- when and on what basis the constitution itself would be reviewed and amended;

- the status of the constitution, for example, whether it is binding on family members or not, or whether it contains a series of principles or merely a broad set of guidelines;
- details of the family succession plan and the anticipated entitlements of family members;
- communication and problem solving, with a focus on preventing and resolving conflict, and only as a last resort a grievance procedure. This could incorporate within the family structures provision for there to be mediation and arbitration. However, the position of a family business in which individual family members have to go to that extent to solve a dispute must be questioned. A family constitution grievance procedure could allow for a much stronger form of dialogue within the family before external parties become involved, for example mentoring and counselling;
- the process by which the executive and chair of the family council are appointed, and more broadly the business governance structure (board, business advisory committee, the role of non-family members, non-executives and advisors);
- the role, if any for spouses and children within the formal family structures such as the family council;
- the opportunities for family members to be provided education both in the formal sense, and including such things as personal skills development programs;
- the basis upon which family members can be employed within the business. Generally constitutions encourage such participation, but do require family members to perform at least at the level of non-family members in the business, be subject to formal reviews and to be remunerated at market rates;
- statements about the intent of the family as a family in business, and incorporating a code of conduct. This can extend to such things as listing core principles, family objectives (vision and mission), family values and the concept of stewardship;
- provision for the ongoing support of family members who have retired from the business. Often, such provisions apply to the founders of the business, typically parents of the next generation who are now engaged in running it, and contemplates that the business will continue to provide a lifestyle to these founders commensurate with that which they enjoyed whilst they were engaged in the business;
- statements of wishes in relation to the administration of discretionary (family) trusts, in particular where there are multiple trusts or where a single trust holds multiple assets covering such things as the business, premises from which the business is conducted and other investments. This can extend to incorporating appropriate mechanisms to protect the assets of a trust by a power of removal of trustee or for the transfer of shares in a corporate trustee if necessary by using put and call options or auto-activating power of attorney clauses, in the circumstances that a family member encounters financial or matrimonial difficulties;
- provisions limiting the persons who may hold shares or ownership interests within companies within the family business group, for example restricting ownership to persons within a particular bloodline or to those fully engaged as employees within the business or that shares must be held by members of the family council from time to time;
- the role of non family managers and employees within the business;
- covenants in relation to confidentiality and covenants not to compete;
- the basis upon which the family and the business will develop business plans and strategies;

- any intent of the family in relation to social responsibility and philanthropy.

A family constitution may take various forms, and may also be referred to as a family deed or a deed of family arrangement. If the document does take the form of a deed, it would generally be because the family intends the terms to be binding.

Increasingly, family constitutions are looking to embrace more holistic issues about the family and its purpose, and such provisions do not fit within the context of a deed.

8.10.Charter of mutual obligations or family rules

A charter of mutual obligations will set out a series of rules which the family will comply with in their everyday lives. It may cover such things as the taking out of life insurance, payment of taxes, keeping the law, attending meetings, engagement in ongoing education and lifelong learning and obligations of financial support by grandparents, for example, by payment of education expenses, and to ensure that wills comply with obligations that the family has made with each other, including by the constitution.

Family rules may go further than a charter of mutual obligations, as they may address codes of conduct amongst the family and within the business. For example, such rules may set the ways in which meetings will be conducted, the obligation of mutual respect, an entitlement to all persons to speak and provide an outline of who may attend meetings.

Sometimes a charter or rules are framed as a code of conduct. There are cases where a code of conduct is extended to include a personal plan for individual family members, the purpose of which is to ensure that the family member in question is aligned with the goals of other family members and the code of conduct in general.

Such issues have been touched on in referencing the setting of meeting rules to achieve best practice corporate governance, or may be contemplated for inclusion within a family constitution. However, it is sometimes necessary for a family to progress in small steps, and the family itself may not be ready to embrace a family constitution or similar broad ranging engagement, in which circumstances either a charter of mutual obligations or family rules can be seen as the first step or one of the steps along the journey.

8.11.Annual re-engagement

Increasingly, families are seeking to obtain an annual recommitment of family members to the terms and conditions of family agreements and constitutions of whatever nature to reinforce commitment to their terms, and so annual re-engagement is required.

8.12.Engagement of a panel of advisors

One adviser cannot possibly hope to have the skillset to address all issues which will be raised by a family in the course of an engagement. Advisors do not only work with family members involved in ownership and management of the business, but generally find themselves liaising with other disciplines such as lawyers, accountants, financial planners and other consultants with skills necessary for the business.

There is real benefit in such multidisciplinary engagement. For example, in preparing a succession plan there must be an understanding of the family business structure and how it is implemented. It is pointless for a lawyer putting in place trust structures, self managed superannuation fund binding death benefit nominations, changing appointors of trusts and even analysing financial statements including balance sheets to determine whether there are unpaid trust distributions or division 7A loan obligations, without consulting the accountant for the business and ensuring that all relevant information has been made available.

It is necessary when a succession plan is made, for all consultants to understand what is involved, to ensure that they understand it, and in future act in a manner which is consistent with the plan agreed upon by the family. By way of example, if there are significant unpaid present entitlements within a discretionary trust to a family member, and a succession plan including a will is implemented where assets within the trust are directed to be controlled following death for the benefit of a different family member, without addressing those unpaid present entitlements as part of the succession plan, significant problems could arise.