



Is It Time for a Governance Transformation for Your Family Business?

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In the early years of a family business – when there are just one or two founders – the need for a formal governance structure isn't strong. But, as family businesses grow, founders often find themselves turning more-and-more to others, friends and trusted advisors, for business advice and expertise. Over time, it's not unusual for founders to establish an advisory council, or even a formal board of directors, for regular input.

Indeed, getting comfortable asking for – and taking – advice is often an evolutionary step on the road to instituting formal governance structures. For example, the creation of an advisory council, however informal, helps founders become accustomed to two necessary elements of any governance protocol:

- sharing information about the business, and
- having others to whom they are accountable (even if it's just in the form of reporting back on a topic that was under discussion earlier).

The more comfortable founders are doing these things, the more likely they are to recognize the benefits of implementing formal governance structures.

Governance and growth

Growth adds complexity – both with regard to businesses and families – and creates, in effect, its own demand for structure. Thriving businesses inevitably reach a point where, to sustain growth, they need to formalize various functions and institute an organizational structure of some sort.

Family growth – whether it's through the addition of in-laws or the inclusion of subsequent generations – also complicates matters when a number of family members are involved (whether actively or financially) with the business. To ensure family cohesion and harmony, and to help ensure the family's values and goals get carried forward to subsequent generations, there usually comes a time when growing families realize they too would benefit by institution of formal structures.

Tidbit

Don't let tax planning be the tail that wags the dog. If you let tax minimization drive your succession or estate planning you risk leaving the family business in an unmanageable situation.

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Comments and suggestions should be addressed to Bruce Ball, National Office by Fax: (416) 367-3912 or E-mail to familybiz@bdo.ca. We invite you to visit our web site at www.bdo.ca to find out more about our firm and the offices near you. Or call us at 1-800-805-9544.

Creation of a board of directors (or a board of advisors which avoids some legal issues) is often a logical step in the evolution of a growing family business. A board, especially an independent one, helps manage risk and can also ensure that the interests of all owners are represented. Family member stakeholders, especially in multi-generational situations or where some shareholders are not too involved in the business, feel additional assurance regarding their stake in the business when a board is in place, particularly when it comes to accounting practices and financial reporting. As well, the board can play a role in the selection of leaders, whether from within the family or from outside.

Cost benefit analysis of formalizing governance

Whether – and when – to formalize your family business’ governance structure involves a cost-benefit analysis. In making the decision about instituting a board, you would weigh the benefits of having one versus the simplicity of a less formal governance structure.

A number of factors come into play in such a cost-benefit analysis and it is complicated by the fact that the weight ascribed to certain factors is subjective or can be difficult to quantify. For example, though determining the cost of remunerating directors and of holding board meetings is straightforward, quantifying the value third parties, such as vendors and banks, ascribe to family businesses with well-functioning boards, especially an independent board, can be difficult.

Is It Time to Hire a CFO?

You’re a creative genius and your sister is a marketing whiz and together you’ve built a solid business that’s grown beyond your wildest imagination (and that’s saying something, given your imagination). Neither of you, however, enjoy – or are particularly good at – looking after financial matters. So far you’ve been able to get by relying on the sound advice of your CA and a few other trusted advisors, but you’re both wondering whether it’s time to hire a CFO.

Here are some questions to consider as you weigh your decision:

- Do you have the ability to manage the business’ finances and to invest any excess funds?
- How much are you currently paying third parties for advice related to financial matters?
- Do you have a long-term financial plan for the business? If not, is there someone within your organization with the financial acumen to create a sophisticated financial plan for the business?
- Is there anyone in the organization with the ability to implement your financial plan?
- Do you have the capacity – knowledge, connections, and relationships – to identify sources of capital to support the business’ growth?
- How much of your time is spent on financial matters that could be spent on activities that you prefer or that you are better suited to?

Designing the right governance structure

Governance structures for non-family businesses have the luxury of only having to deal with ways of enhancing the success of the business. In a family-owned business your governance structure must be capable of dealing with issues related to the family as well as the business, which complicates matters.

Because of the unique nature of family-owned businesses, there are a number of issues specifically related to family involvement that

should be considered when designing a governance structure. For example, with regard to the makeup of the board, the following should be considered:

- Should family members automatically be included on the board? If so, should a certain number (or percentage) of directors be family members?
- Should certain roles or positions (for example, board chair) always be filled by a family member or should the role family members take depend on their skills and experience?

Tidbit

Because everyone learns differently, you’ll get more out of your training dollar if you ensure the training method is compatible with the employee’s learning style.

- If family members are on the board, should they be elected or appointed? If elected, should there be choices among family members when filling the seat?
- If family members serve on the board, should they serve for a fixed time (to allow other members to serve)?
- Should family members be remunerated for their work on the board? If so, what should the remuneration be, or how should it be determined?

Aside from issues related to composition of the board, other important governance-related matters that are unique to family-owned businesses relate to employment of family members and to share ownership. For example, with regard to employment of family members, the following policies should be addressed when formalizing the governance structure:

- Policies regarding qualifications needed for family members to be hired;
- Policies regarding hiring of in-laws;
- Policies regarding performance evaluation of family members employed in the business;
- Whether certain management positions must be filled by family members.

Issues related to share ownership that should be addressed when formalizing the governance structure include:

- Voting rights attached to family members' shares;
- Dividend rights attached to family members' shares;
- Adoption of a shareholder's agreement (if one doesn't already exist);

- A means for family members to liquidate their ownership, including consideration of whether liquidation should be voluntary or mandatory in particular situations;
- Whether family members will be required to execute prenuptial agreements.

Family council's role

As noted, in addition to success on the business side, leaders of family businesses are equally concerned with the family side of the equation. For most owners, making sure their family flourishes and making sure their values are handed down is as important as making money. And, as families grow, ensuring family harmony, prosperity, and shared commitment to the values and vision of the founder, requires attention and effort and communication plays an important role in these efforts.

The way business matters end up getting communicated between and among family members tends to develop over time, evolving from discussion around the Sunday dinner table to organized family meetings or get-togethers and retreats with fairly structured presentations and discussions by those active in the business. Creation of a family council is one of the best ways of ensuring family members and family matters receive the attention they need to flourish.

Important information can be disseminated through the family council and it can provide a means for family input on issues directly impacting family members, such as the development of policies regarding employment of family members and share ownership. It also provides a mechanism for holding the company accountable

to family members. As well, family members can hone valuable leadership skills on the family council – skills they might later use in leadership positions on the business side.

Because a family council is, in effect, a governance structure intended to attend to matters related to family members, to ensure its success, when creating a council it's useful to establish policies related to things like:

- Representation on the council;
- Structure of the council;
- Responsibilities of the council;
- Power of the council.

Enshrining your vision

While there are many reasons it's a good idea to formalize the governance structure of a business, one of the main reasons for doing so is because a solid governance structure can help ensure that your strategic direction is maintained. And, in a family-owned business, instituting formal governance structures is also the best way of ensuring that the business continues to reflect the family's principles and values.

Tidbit

One of the simplest ways of comforting your employees during this difficult economic time is to maintain open communication with them. Letting them know you have a plan, even if it's only a short-term one, will help them feel more confident and keep them focused on the task at hand.

Tidbit

There may be ways of lowering your payroll without letting staff go. For example, consider four day workweeks, partially-paid sabbaticals or eliminating a benefit that's not particularly popular

What Can Happen If You Don't Have a Succession Plan?

Most business owners realize they should have a succession plan and many can even explain the two most commonly cited reasons why they should have one:

- to prevent fighting among family members for control, and
- to minimize disruption to the business.

And yet, statistics show that many business owners – even those who are at, or nearing, prime retirement age – don't have succession plans. At the risk of harping on the negative – perhaps a closer look at some ways these negative consequences might play out will help persuade owners who have not quite gotten around to beginning the succession planning process that they should attend to it, now.

When an owner dies without a succession plan and there is more than one family member that may end up at the top, all sorts of rivalries can bubble up. This is true even where no rivalries were apparent while the founder was alive. (Keep in mind that potential successors are often on their best behaviour while the founder is around, especially if they're trying to prove they're capable of leading the business and those involved in it.)

Rivalries can be exacerbated if, for example, the founder leaves a number of people with the impression that they are in line to take over. (It's not that uncommon for founders to leave this impression, given the natural inclination to not want to hurt people by letting them know they are not in the running.)

Even if, after the death of the founder, family members come together and agree on a successor for the good of the company, the successor could end up being powerless if he or she does not have the full trust and support of everyone. In such cases, when the person does take over, family dynamics can come into play creating factions that can undermine the new leader's authority.

It's important to realize that even if the founder names or announces who they want to succeed them, business disruptions are still possible, especially if the successor is not already at the helm at the time of the founder's death. If the ultimate successor has not taken over the business while the founder is alive, he or she will face a tremendous learning curve and the founder will not be around to turn to for advice.

As well, if the founder did not turn over the helm before he or she died, it could be because the heir is not ready to take over the business – ready in terms of age, education, or experience – in which case the business will be in trouble and family squabbles may surface if others decide to try to exploit the power vacuum. So, if an owner chooses someone who is not currently ready to take over, he or she should also make contingency plans to ensure the business' ability to function until the successor is ready.

While it's true that problems can arise even with a carefully executed succession plan, by not having one you are increasing the risk that your business and family will suffer.

Tidbit

Make sure you never leave home without it – your business card, that is. To ensure you're never without one, leave a stack in coat pockets, your car, your gym bag, your brief case – even your golf bag.

Q&A – Getting the Family On Board When Selling the family business

Q. We are a family business in our third generation. There are three of us running it: me, my brother, and our first cousin. My brother is the oldest – he’s 73; my cousin is 70; I’m 69. All of us have family members who are involved in the business and who are minor shareholders (they own a total of 10%). We’ve been running family councils for about 10 years now and it’s very clear no one in the next generation (or even in the generation after that one) is interested in taking over the business. So, it seems inevitable that we’ll either have to eventually close it or sell it.

Over the years we’ve had the occasional offer to sell, but nothing we ever took seriously and the last offer was probably three or four years ago. We have a family council meeting coming up in a few months and putting the business up for sale will be an agenda item. Any suggestions for pitfalls we should discuss – or, to put a more positive spin on it – for things we can do to ensure the process goes as smoothly as possible?

A. First off – congratulations on being part of a thriving third generation family business – it’s always great to hear. You’re to be commended, as well, on the fact that you’re looking ahead. We do have some suggestions on how to make the process as smooth as possible. First off, though selling the family business is likely to be an emotion-laden proposition for you and your

family members, from the buyer’s perspective the transaction is no different from any other purchase. Though you know doubt have always realized the importance of separating family issues and decisions from business decisions – this is especially important when it comes to selling because it can be a particularly emotional time.

In terms of readying the business for sale, you should attend to the typical matters a seller would attend to – things like ensuring all your financial statements are in order and ready; having an objective view of the business’ value; identifying potential buyers, lining up financial and legal advisors, etc. Given that you mentioned you’ll be taking up the issue at your next family council, we assume you’re more interested in issues that may come up at the meeting and things you should get family members to start focusing on in anticipation of a sale.

One of the key issues to openly address is whether family members must unanimously agree to sell, or whether, for example, a majority will be enough. Some family business advisors argue that unanimity among the shareholders should be required when selling the business in order to keep peace in the family. Another practical reason for requiring unanimity is that if a potential buyer senses disagreement or discontent among family members, they may walk away, or they may try to exploit the

situation by pitting family members against each other. We leave it to you and your family to decide how the decision will ultimately be made, but we strongly urge you to address the issue at the family council because, though there is always a chance family members may not be pleased with the ultimate decision reached, the chance of dissatisfaction or resentment is always greater if people do not feel they were at least heard on an issue.

Another important issue to discuss is the logistics of any negotiations that may go on in selling the business. Who will be involved in the negotiations, for example? How much latitude will the negotiator(s) have and what factors will be deal breakers as far as family members are concerned?

Another practical matter you should attend to in anticipation of negotiating a deal is how you are going to keep family members informed of the progress of searching for a buyer and of any negotiations. If you don’t already have a reliable communication mechanism in place, institute one. Also impress on family members their need to be available, should the need for an extraordinary family council meeting arise or should their signature be needed on documents, etc.

Good luck with the family council meeting and with whatever decision you and your family make regarding selling your business!