Section 4 Development and consolidation

Introduction

This fourth section looks at issues that arise when a business is established and enters the development stage of its life cycle. It starts by looking at strategic planning and how families in business can approach this vital task, including the possibility of creating a family constitution.

It moves on to look at employment issues: working with family members and with non-family members, including the advantages and pitfalls of introducing managers from outside the business, and setting up and working with a board of directors.

Following a topic on marketing family businesses are three topics that focus on financial matters, including preserving wealth, tax planning, insurance and venture capital.

The section ends with a look at the conflicts that can beset family businesses and how best to deal with them.

Learning outcomes

In this section you will be concentrating on the following learning outcomes:

- deepen your understanding of the life cycles of the family and the business
- analyse your business's policies and practices for employment, marketing and finance
- analyse the causes of conflict in your family business
- critically analyse your own situation and devise strategic action plans.

Topic 1: Strategic planning 1

When you have worked through this topic you should be able to:

- outline the stages involved in strategic planning
- summarise the issues affecting family businesses at each stage.

Topic 2: Family strategic planning

When you have worked through this topic you should be able to:

- describe what is involved in ‘family strategic planning’
- summarise the importance and content of a family policy
- understand the value in strategic planning of help from people outside the business.

Topic 3: A family constitution

When you have worked through this topic you should be able to:

- suggest reasons for drawing up a family constitution
- summarise the key elements of a constitution.

Topic 4: Employing family members – key issues

When you have worked through this topic you should be able to:

- list the main issues and conflicts that can arise when employing family members.

Topic 5: Employing family members – policy and practice

When you have worked through this topic you should be able to:

- set down what policy the business should have for employing family members
- understand the importance of relevant skills and experience for all family employees.

Topic 6: Employing family members – good practice

When you have worked through this topic you should be able to:

- outline the importance of family members having experience beyond the family firm
- say why equality of treatment between family and non-family members is important.

Topic 7: Working with non-family members

When you have worked through this topic you should be able to:

- summarise the benefits and drawbacks for non-family members working in family businesses
- assess how far your business follows good practice in employing non-family members.

Topic 8: Appointing non-family managers

When you have worked through this topic you should be able to:

- summarise the benefits that employing non-family managers can bring to the family concern
- outline the difficulties that can arise between the family business and non-family managers
- list steps that can be taken to assist the smooth entry of managers into the business.

Topic 9: Boards of directors

When you have worked through this topic you should be able to:

- summarise the advantages of having an independent board of directors
- describe the different skills and qualities that good non-executive directors can provide.

Topic 10: Marketing the family business

When you have worked through this topic you should be able to:

- explain why family businesses are particularly strong in some market sectors
- describe ways in which family firms can use their status as a promotion tool.

Topic 11: Financial matters 1 – wealth preservation

When you have worked through this topic you should be able to:

- explain the importance of wealth preservation to family businesses
- explain the importance of building an asset base outside the business.

Topic 12: Financial matters 2 – insurance

When you have worked through this topic you should be able to:

- summarise the types of insurance that family businesses should consider taking out
- explain the reasons why life insurance may be necessary and the uses it can be put to
- assess how well and how appropriately your business is covered by insurance.

Topic 13: Financial matters 3 – tax planning and venture capital

When you have worked through this topic you should be able to:

- summarise the types of tax that the business may be liable for
- outline the possible uses of venture capital to family-run businesses
- explain reasons for family firms' reluctance to use equity finance.

Topic 14: Family business, family conflict

When you have worked through this topic you should be able to:

- describe some of the conflicts that can arise in family-run businesses.

Topic 15: Causes of conflict

When you have worked through this topic you should be able to:

- identify some of the most common causes of conflict in family-run businesses.

Topic 16: Dealing with conflict

When you have worked through this topic you should be able to:

- describe the steps involved in dealing with conflict
- explain the importance of seeking help from a mediator outside the business and/or family.

Section 4 Development and consolidation

Topic 1 Strategic planning

All businesses must have an idea about the long-term future of the business. Even if it is not formally written down in a strategy or a plan, the owners and/or managers will have an idea about what they want the business to achieve and how they hope to achieve it.

This topic looks at strategic planning, but with the focus on the particular needs of family-run businesses.

> **Over a third of all family-owned businesses do not have a business plan. Perhaps it is no surprise that nearly half of all 'micro' businesses employing 1 to 5 staff, have no business plan. However, it is worrying that 30% of businesses employing 21 to 100 staff and a further 14% of those employing over 100 staff have no business plan.**
>
> **Bournemouth University Business School (1999)**

Strategic planning

Strategic planning 'provides a systematic way of asking key business questions and is designed to create insights into the company and the environment in which it operates' (Ward, 1987). Strategic planning, by definition, involves a challenge to the status quo and opens up the possibility of change.

According to the SESAME module on 'Entrepreneurship and competitiveness', strategy embraces the management processes (usually formal decisions and actions) where the actions:

- focus on the long term, rather than the day-to-day affairs necessary to run the business
- change resources used by the business
- change products, how they are marketed, when they are developed and when they are dropped
- change the organisation's structure and processes.

Agreeing a strategy and carrying it out requires planning. For all businesses (whether family concerns or not), the steps in the planning process are the same and are shown in the following diagram.

Where is the business now?	**Stage 1** Objectives	• What do the owners and key stake-holders want? • Where does the business need to be by the end of the plan?
	Stage 2 Resource audit	• What are the organisational strengths, weaknesses and capabilities that assist or impede the firm in attaining the objectives?
Where does the business want to be?	**Stage 3** Strategic targets	• What steps need to be taken to plug the resource gaps and achieve a competitive advantage?
How will the business get there?	**Stage 4** Operational plans	• Who will do what by when?
	Stage 5 Monitoring and control process	• How will we know if we are winning?

Ward, J.L. (1987) *Keeping the Family Business Healthy*, Jossey Bass Publishers, p. 98

For family-run businesses, there are particular issues relating to the family's involvement in the strategic planning process.

- What issues does the firm's status as a family concern bring to the process?
- How does the family approach the strategic planning task?
- What is the family's own 'strategic family plan' that has to co-ordinate with the business strategy?
- Do family dynamics make the planning process easier or more difficult?

At each stage of the planning process there are particular issues affecting family-run businesses.

Stage 1: Objectives

This is the stage of the strategic planning process, where the firm's status as a family business can have most impact. Asking the question, 'What do the owners and key stakeholders want?' raises questions about what the family is in business for: to make a profit, to build a reputation, to create a lasting legacy for future generations, to establish a place in the community, or a combination of these things?

These questions are discussed in Section 2, Topics 6 and 7, which examine in detail the relationship between the family's values and its business goals and objectives.

Stage 2: Resource audit

What the business can achieve is determined – or even limited – by the resources it has available to it. Key resources include both finance and human resources. Both of these are areas where family businesses may be hampered by what is often identified as a conservative approach to business decisions and a reluctance to look beyond the family for input into the business. This does not apply to all family businesses by any means, but is a recurring danger for some.

In taking an honest look at resources, the logical conclusion may be that the family itself cannot provide all the skills necessary for the business to succeed or grow. This may be a conclusion that the family is unwilling to acknowledge, which is why the family itself may avoid reaching the decision in the first place.

Involving an objective, external consultant in this process is, therefore, a constructive step. You will consider this issue later in this Section (see especially Topic 2).

Stage 3: Strategic targets

The third stage is about crystallising the ideas into action, and depends on the first two stages having been carried out thoroughly. For family businesses the key questions include:

- who will be involved in agreeing strategic targets?
- how will the business's targets relate to the family goals?

Stages 4 and 5

In these two stages, what needs to be done follows from good business practice rather than anything specific to strategic management.

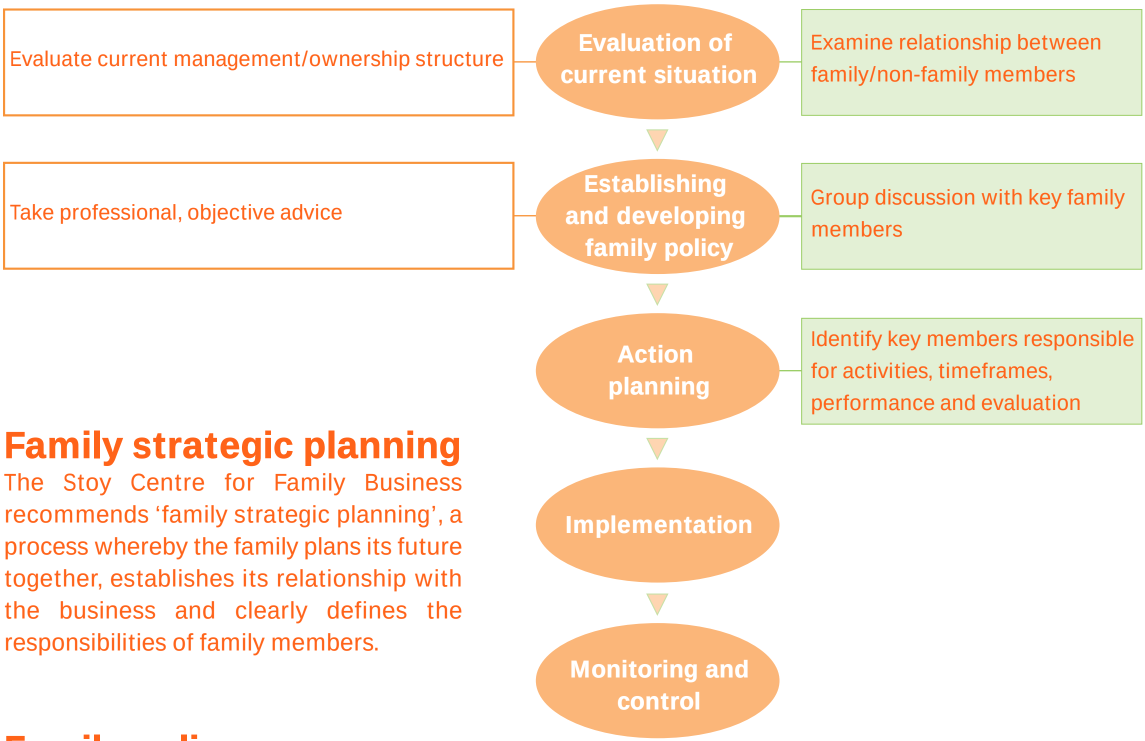
Topic 2 will continue this exploration of strategic planning and will look at ways in which family-run businesses can approach the planning process.

For a much more detailed study of strategy and strategic planning in SMEs, look at the SESAME module, *Entrepreneurship and competitiveness* (Unit 2, 'SME and strategy').

Section 4 Development and consolidation

Topic 2 Family strategic planning

In Topic 1 the suggestion was made that family-run businesses need to take a two-track approach to the task of strategic planning: that is, marrying up the family's own plans and goals with those of the business. This topic continues the theme by looking at how these two aspects of planning may be synthesised in 'family strategic planning'.



Family strategic planning

The Stoy Centre for Family Business recommends 'family strategic planning', a process whereby the family plans its future together, establishes its relationship with the business and clearly defines the responsibilities of family members.

Family policy

The key part of a family policy is understanding how the family and the business interrelate. This means understanding and agreeing what the family's commitment to the business is. Some of the questions that families have to answer are:

- Is the whole family committed to the business? – This may seem a rather basic question to ask, but if the honest answer is 'no', then it may be that the business does not have a long-term future.
- What is the depth of that commitment? – For example, are family members ready to sacrifice material gains in order to invest money back into the business? Or is the aim of the business simply to provide the best possible income for family members for as long as possible?
- Is the family willing to maintain its commitment for a length of time, e.g. the time needed to build up the business?
- Are family members ready and willing to work together for the good of the business?
- Where does the future of the business lie? Does the next generation have the interest, willingness and leadership skills to take it over?

Discussing and finding answers to these questions will provide the family with an agreed framework for approaching the task of business planning.

Objective advice and help

Strategic planning is one area where help from people outside the business can be of great value. Such people might include:

- non-executive directors (NEDs)– especially non-family members
- professional advisers
- management consultants.

All of these can provide an objective view of the business, its strategy, and the family's roles and responsibilities in developing and implementing it. NEDs who are also family members may be able to provide useful advice, but their family involvement may make it more subjective than that of non-family NEDs.

It may be appropriate to create a formal 'advisory board', a panel made up of a mixture of advisers, managers, and non-executive directors. If the business is a company, the role of such a board would need to be in accordance with the company's Articles of Association. It may even be necessary to amend the Articles to permit such an advisory body. The amendment should be carefully worded so as to limit the board to an advisory, rather than an active management role. Areas that the board might be empowered to advise on include:

- counselling and advising officers
- suggesting strategic policy
- providing advice on management succession.

For more about non-executive directors, see Topic 9.

Strategic planning and the smaller family business

The approaches suggested above are suitable for a well-established, quite large family firm, where complexities have developed over time. For a smaller business, such as the Normans' husband-and-wife flower business (see Section 3, Topic 11), such a formal approach may not be necessary. It is still important to discuss how family life and the business interrelate, but agreement can be reached through more informal means.

Check Point

Strategic planning

How does your business approach the task of strategic planning? You may already have a strategic plan in place. If so, take this opportunity to review progress. Note down your ideas and suggestions in Action plan 4 in Section 6.

Use the diagram opposite to create your own framework for action:

- Summarise the steps needed to set strategic planning in motion, e.g. who needs to be consulted, who would be involved in planning.
- Set target dates for each stage of the process.
- Identify who needs to be involved from within the family at each stage.
- Identify who could be used as professional advisers or NEDs at each stage.

Family policy

What is your family's policy towards the business? Think about these questions and note your ideas in Action plan 4:

- Is the whole family committed to the business?
- What is the depth of that commitment?
- How long is the family willing to maintain its commitment?
- Are family members ready and willing to work together for the good of the business?
- Where does the future of the business lie?

Section 4 Development and consolidation

Topic 3 A family constitution

Agreeing a family policy towards the business and the family's role in it is a key part of 'family strategic planning', discussed in Topic 2. This family policy should be part of a wider set of agreements that the family puts in place to handle:

- the family's relationship with the business
- family members' relationships with each other.

Establishing a family constitution may be part of that process.

This topic follows on from the previous two, and from Topic 11 in Section 3 – you may find it useful to read through those again quickly now.

A family constitution

Throughout we have stressed the importance of families in business discussing and agreeing a number of key issues:

- common values and goals – see Section 2, Topics 6 and 7
- an overall family policy – see this section, Topic 2.

Some families with active business interests go further and formalise what they have agreed in the shape of a 'family constitution'. This is a document that spells out in clear terms the family's values and policy, and how it puts these into practice.

The constitution should include broad statements, describing the family's moral and ethical stance. Alongside these, it may specify 'rules' of behaviour in all aspects of the family's work with the business, from holding family meetings, to rules about who may own the business, to systems for appraising performance.

The greater the number of family members involved in the family firm, and the more complex the business activities, the greater the value of such a constitution.

The checklist below summarises some of the main areas a family constitution would typically cover.

Checklist: Items in a family constitution

Role of meetings	**Management responsibilities**
○ frequency of meetings	○ employment guidelines
○ participation	○ appointment of board of directors and its powers
○ rules of order	○ criteria for selection of advisers
○ chairman's role and appointment	○ employee job appraisal
Family involvement in business	**Family values and duties**
○ leadership responsibility	○ common values and goals
○ formal means to share personal career goals	○ means for ongoing communication
○ family job specifications	○ obligation to be open minded and respectful of others
○ remuneration of family members	○ rules for optimism
○ family job appraisal	
Ownership of business	**Conflict resolution**
○ who may own an interest in the company	○ rules of behaviour
○ voting and share ownership	○ steps to take in case of conflict
○ guidelines on shareholding succession	○ acceptance of mediation
○ responsibilities of shareholders and directors	○ criteria for selection of mediators

An excellent example of a complete family constitution is included in Leach and Bogod (1999, pp 84-85).

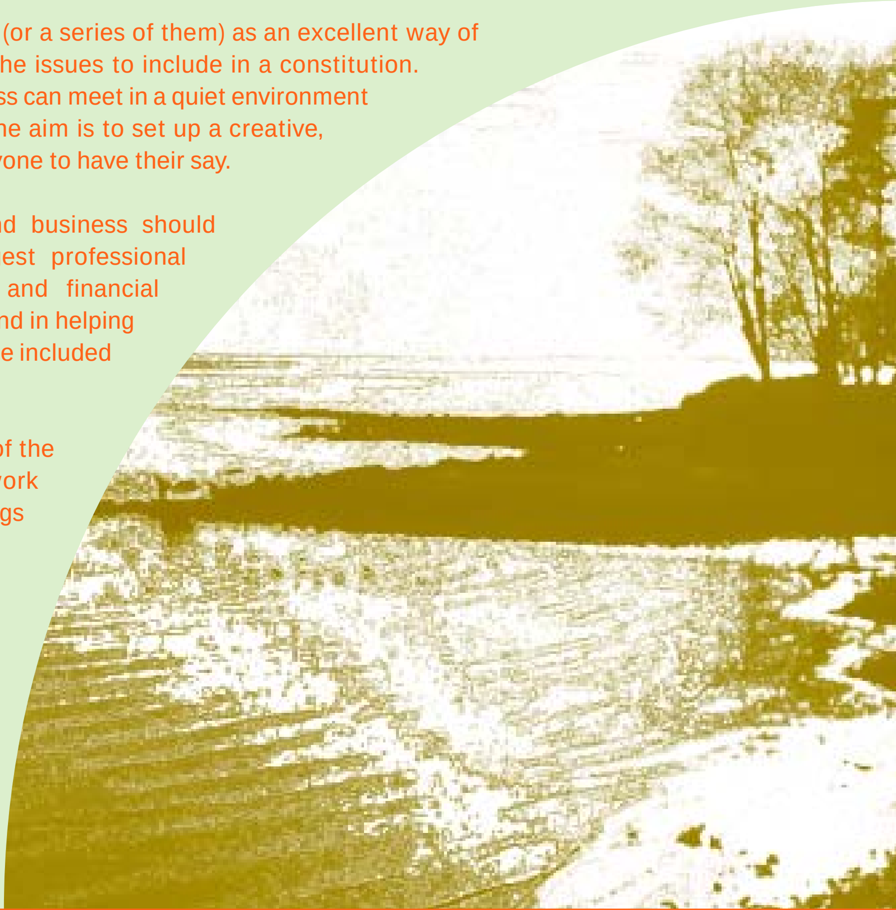
Agreeing the constitution

Leach and Bogod recommend a day-long retreat (or a series of them) as an excellent way of starting the process of reaching agreement on the issues to include in a constitution. Everyone from the family who is part of the business can meet in a quiet environment away from both business premises and home. The aim is to set up a creative, non-confrontational atmosphere that allows everyone to have their say.

Ideally, facilitators from outside the family and business should conduct the meeting. Leach and Bogod suggest professional consultants with broadly based commercial and financial experience, skilled in managing group dynamics and in helping family-owned businesses. (Sources of such help are included in Section 7, Resources).

A clear agenda should allow both for discussion of the broad strokes of family policy, and for detailed work on specific rules, such as how and when meetings will be held, and who will be involved.

It may be that not every family member can agree on every item in the constitution – in fact it would be extraordinary if they did – but simply having clear, written rules that have been discussed openly will eliminate the scope for disagreement and ambiguity that bedevils so many family businesses.



Check Point

Answer the following questions before turning to the Action plan in Section 6.

Family constitution

1 Do you have a family constitution? ○ Yes ○ No

2 If you don't have a family constitution, would the business benefit from having one? ○ Yes ○ No

3 Draw up an agenda of items to consider for inclusion in your family constitution and think about who would need to be involved in the discussions to agree the constitution.

Section 4 Development and consolidation

Topic 4 Employing family members – key issues

One of the biggest problem areas faced in family businesses concerns what happens when family members come into the business – or *want* to come into the business. If this issue is not handled properly, problems can erupt straight away, or else they can bubble away under the surface for months, even years, before finally exploding. And when the explosion comes, it may already be too late: the business may have hit the rocks or rifts may have opened up between members of the family or between family members and other employees.

There must be a place in the company for little Jimmy. He's family after all.

This topic raises some of the issues that arise when a family business has to consider the possibility of widening its net to include other family members as employees.

The family business as employer

For a business seriously to consider employing other people, it must have reached a certain stage of development – and size. One common situation is when a partnership realises that the business has got bigger than they can comfortably handle and they need to take on extra help to cope. Another is when the original founder is considering the question of succession, i.e. employing someone in the next generation to take over the business. This topic is considered in detail in Section 5.

However, the question of employing family members is more likely to arise when the business has reached the second or third generation. By this stage:

- the business is likely to have an established history that suggests a promising future
- ownership and management is likely to have diversified from the original founder, inside or outside the family
- the network of family members involved may have grown from the founder's nuclear family discussed in Section 2, Topic 1

By this stage, family members may regard the business as a 'family resource' to be utilised for the good of the individual and their branch of the family – the natural place for 'young Jimmy' to look for a well-paid job. Consider the following situation:

Peter is MD of the family business. He needs a new Sales and Marketing Manager. His nephew Grant is currently part of the sales team but is by no means the most senior.

Mary, Peter's brother, is Grant's mother and is a non-executive director. She is keen for Grant to be given the job of Sales Manager and is putting a lot of pressure on Peter and the other directors.

Grant has spent three years in the sales department of the firm and has found them quite tough, especially to begin with when he got a lot of stick for being related to the boss. He is keen to get the job as Sales Manager, but doesn't want to get the job through nepotism.

Jenny, Peter's niece (daughter of his brother Geoff), has worked in the Finance Department of the local council for several years. She is getting bored with that and thinks it could be a smart move to join the family firm, although she doesn't have much experience of marketing.

Activity

What are the main issues in this situation?

What is the potential for conflict?

What would you do in this situation?

Some of the key questions that this situation raises are:

- On what basis should Peter make the decision about whom to employ?
- Should family members be given priority over non-family members?
- What, if any, is the firm's policy about employing family members?
- Which of the available options will be best for the long-term future of the company?
- How do you proceed when family interests and business interests clash?

There is potential for conflict:

- between Peter and Mary, both directors of the company, over whether Grant should have the job
- between the business and other employees, if they feel the job is going to someone unsuitable or unqualified
- between different branches of the family if they feel aggrieved over who is employed and who isn't.

... joining the family firm is not a given. Respondents with children not yet in the business were asked 'Do you intend that your children should join the business?' An overwhelming majority, 71 per cent, said 'only if they want to' and only 7 per cent said 'yes'.

The Family and The Business: An International Study. Grant Thornton

Check Point

Note down your answers to the following questions below.

Then when you have completed the next two topics, turn to Action plan 4 and summarise your thoughts about employing family members.

Has your family business employed family members above and beyond those who originally set up the business?

If so, on what basis were the family members employed?

On the whole, has this proved successful? What are the reasons for the success or lack of it?

Section 4 Development and consolidation

Topic 5 Employing family members – policy and practice

This topic continues the theme of Topic 4: employing family members. Here, you will consider the importance of the family and business having an agreed policy about employing family members. You will explore some of the aspects of employment that such a policy would cover, including skills and experience.

What is the policy?

Businesses vary hugely in their attitude towards bringing family members into the business. At one extreme, there are businesses that will always find a place to put a family member. At the other extreme, family members have to compete alongside non-family members for any available position – and may even have to go that extra bit further to prove their suitability to join the business.

Work through the following activity to establish what your own business's policy is.

Activity

Read through the following statements and decide whether you agree or disagree with each of them.	Agree	Disagree
1 I believe that the business is there to serve the family and that we should bend over backwards to find family members a position if they want one or need one.	○	○
2 I believe in giving priority to family members, and the closer the family member, the higher the priority. A son or daughter should have priority over a nephew or niece, who should have priority over a cousin, and so on.	○	○
3 In-laws are family too. If my brother-in-law wanted to join the company, I would do my best to support that.	○	○
4 I believe that family members should only be employed if there is a genuine position available in the company and, even then, they should have to apply for it alongside anyone else who wants to.	○	○
5 If there are two equal candidates for a position, the family member should be given priority over the non-family member.	○	○

Your responses to these questions will be determined by your views of the purpose of the business, but they should also be determined by the business's strategic plan – as discussed in the last Topics 1 and 2. Part of this planning process involves formulating a family policy, which should make clear the family's attitude to the business – and by extension, to employing family members.

For the family-orientated business, involving future generations may be one of the key goals; in this situation, giving priority to family members will be an important part of that policy. The next Managing Director may be expected to come from among the crop of children in the next generation and so the business may deliberately nurture all those keen to take a role in the company.

What the family policy should include

Matters that the family policy should consider include:

- the overall policy towards employing family members (beyond the founders of the business)
- the level of priority given – if any – to family members
- the skills and experience expected of family employees
- conditions of employment
- shared values.

Skills and experience

In the modern competitive market-place, the days of employing family members regardless of their abilities are long gone. For the vast majority of family businesses, an essential condition for taking on family members is that they have the requisite skills and experience – or, if they don't currently have them, can show themselves willing and able to acquire them through training.

There are different approaches to employing family members, providing different routes to the desired goal of a fully trained employee working successfully in the correct place in the organisation.

1. Bring the family members into a suitable position that matches their existing skills and experience.
2. Place them in an available position, and provide the training and support necessary for them to fulfil it.
3. Work out a structured programme of 'shadowing' existing employees, so that they get to know the business from the inside out.
4. Let them spend some time just getting to know the business – contributing whatever they can wherever they are needed.
5. Simply let them start at the bottom and work their way up if they have the motivation and aptitude to do that.
6. Encourage the family member to take a college course appropriate to the technical basis of the firm (e.g. engineering, printing) and, possibly, take a business qualification later, e.g. DMS or MBA.

Activity

1. What do you think are the advantages and disadvantages of these different approaches to employing family members?
2. Which of these approaches would you favour? Which would be most suitable for your business?
3. What is the current approach in your business?

These are very different approaches, ranging from the highly structured (3), to the completely unstructured (4), which could prove to be ineffective and unsatisfactory for all concerned: the employee won't have a clear idea of what their role is and other employees may feel unnerved at having them 'hanging about'.

The first option is efficient, in that the employee becomes productive immediately, but several of the other approaches depend on having good systems for training in place.

Different approaches will suit different situations, depending on the business's overall objectives and available resources. It also depends on whether the business can afford the luxury of taking on a family member as an employee who may require more training than a non-family member.

Starting at the top? Once deciding to join the business, the next generation will likely have to work its way up. In Canadian family businesses, 74 per cent of those surveyed agreed with the statement, "Children who join the business should start at the bottom".

The Family and The Business: An International Study, Grant Thornton (2002)

Section 4 Development and consolidation

Topic 6 Employing family members – good practice

In Topics 4 and 5, you considered different approaches to employing family members. This topic continues the theme, looking in particular at the value of gaining experience outside the family firm, and other practical issues such as conditions of employment.

> Fresh from school? One of the key findings showed that, irrespective of country or culture, the majority of owner-managers in most countries surveyed had joined the business after working elsewhere for a number of years. The notable exceptions were Italy and the USA, where a higher proportion of owner-managers joined directly after completing their studies.
> **Grant Thornton (2002)**

Experience outside the family firm

Many owners/managers of family-run businesses regard it as highly desirable that any family member joining the business should have gained successful work experience elsewhere before joining the family firm. Some would regard it as essential, for the following reasons.

- It provides valuable experience of working practices and methods outside the family business.
- It gives the person confidence in their abilities.
- It provides useful evidence to the current owners/managers about the person's abilities.
- It may pre-empt criticism from other employees about the person's fitness to be employed.
- The person may have built up a useful network of contacts that could prove useful to the family business.
- It also brings new ideas to the family business, which may have become stale and set in its ways.

Ensuring equal treatment

When employing family, it is important that they are treated equally with other employees and not taken for granted. It is especially important that things such as salary and conditions of employment are consistent with those of any non-family members employed by the business. If family members are underpaid or are expected to put in unpaid overtime 'for the good of the family', they may feel exploited and dissatisfied with their role.

On the other hand, if family members are overpaid or indulged in other ways, they may lose their competitive edge and become complacent. As we have already noted, this may also create disaffection among other employees who feel they are being treated unfairly.

Equality of treatment is not just a question of pay. Family employees should receive – and be seen to receive – equal treatment in all areas, including:

- conditions of employment – timekeeping, holidays, maternity leave
- training opportunities
- pension schemes
- other benefits, e.g. medical insurance.

By the same token, family employees should not be given preferential treatment in any of these areas.

> I think the days of the 'family sponge' are long gone – you know, the good-for-nothing younger son who treated his job with the family firm as a welcome source of income, but found it very tiresome to have to do a couple of hours' work before heading off for a long liquid lunch. Sure, there will be an element of freeloading in some firms, but basically, there are no free rides in business any more. Businesses just can't afford it.
> **Will Parfitt, Manager of one branch of Parfitt's Chemists**

> You not only have to put in as much as the non-family staff, but if anything, a bit more – you can't be seen to be trading on your family name. At the first sign of slacking, there'll be rumblings of discontent!
> **Josh Levine, employed in the family firm, James Levine & Sons**

Values and goals

So, you are about to take on a member of the family as an employee. The next question is: How important is it that they share your values and goals, and those of the business?

The answer of course is that it depends on the values and goals: if the business has a strong family orientation, then it is likely that new entrants will have a fairly realistic view of what working for the family business means. They will have witnessed at first hand the efforts made by their parents/uncles/aunts/grandparents to build the business and will understand only too well the implications of that.

Joining the family firm is likely to be a conscious decision and may even involve some material sacrifice, as the following quote illustrates:

> The decision to join the family firm has cost me at least £20,000 a year! With my degree in engineering and several years' experience with a major aerospace company, I could command a salary that was nearly double what the family business can afford to pay. But there are other, more important reasons for joining than money.
>
> **Saadia Amed, employed in family clothing business**

If, on the other hand, the business has a low family orientation, but a high business orientation, then the predominant 'value' may be the profit motive. As employers, you would no doubt be looking to take on people who shared that motivation and could show themselves willing to work hard. In this situation, selection is likely to take place purely on merit, regardless of any family relationship.

Check Point

What is your approach to employing other family members? In order to start drawing up your family policy, go through the items in the list in Topic 5 (repeated here) and think about how they appear to your family business. Think about all the following before turning to the Action plan in Section 6.

- the overall policy towards employing family members (beyond the founders of the business)
- the level of priority given – if any – to family members
- the skills and experience expected of family employees
- conditions of employment
- the importance of shared values.

Section 4 Development and consolidation

Topic 7 Working with non-family members

This topic and the next look at two aspects of working with non-family members: Topic 7 covers general principles that apply to all non-family members employed by the business, while Topic 8 explores the particular issues that arise when non-family members are given key management roles.

Non-family members as employees

Some family businesses are exclusively family concerns: only members of the family are involved. But for many family businesses, much of the work is done by employees from outside the family. Because family businesses so often have a distinctive character, working for this kind of firm can be quite different from working for other types of business. Here is what a few employees of family concerns have to say:

I really like the informality in the company – you really do feel it's a family firm and that you are part of the family.

Everyone has a sense of pride working for the company. There are several of us who have been here for over 30 years. We knew the current owner's father and have been delighted to see his daughter take over and run things so well.

It's good to have direct contact with the boss. He knows everyone as an individual and is happy to see anyone about any problems they may have. You feel they take staff welfare seriously.

It's a family firm in every sense: there are people here whose parents have also worked here. That's the thing: they'll make an extra effort to find a spot for family members, like my son who worked in the warehouse as a summer job.

The picture isn't always so rosy – working for family firms can have its frustrations:

I dislike the patronising attitude – it's as if the boss is the lord of the manor and we are the serfs and should count ourselves lucky to be paid peanuts to work for him.

After I was taken on, I asked about joining a union. The reaction was of complete horror – you'd think I'd suggested boiling up the boss's children for lunch.

We do all the work and they get all the benefits. If I put a foot wrong, I get an earful, whereas the family members get away with murder. Long lunch breaks. Days off. And that smug expression that tells you they can because they've got the right name.

The worst thing is all the back-biting and intrigue. There's so much friction between the family that it really makes it hard to do your job.

Royalist or republican?

It may well be that people who enjoy working for family-run businesses share similar values and goals to the owners/managers. They feel dedicated and committed to the firm, and are willing to offer a high level of loyalty in return for the security and acceptance they feel.

Those who don't enjoy working for family concerns may feel as they do because they are uncomfortable with the mixture of business and family matters: they find the family orientation of the firm at best a distraction and at worst impossible to deal with.

Good employers?

There is a perception that family-run businesses are often good employers and pay attention to things such as conditions of employment and staff welfare. Is this perception accurate? Some of the ways in which family businesses can prove themselves attractive employers are by providing:

- good working conditions
- opportunities for training and development
- employee benefits, including pension provision
- a reasonable holiday allowance and an understanding attitude towards unpaid and parental leave
- good communication and consultation – respect for ideas and input into business by non-family members.

This is the ideal and can give family firms a competitive edge – but it shouldn't be forgotten that there are also bad family employers as well as good ones.

One important thing that family businesses can do is to make clear the importance of even-handedness in the employment of family members and non-family members. If all are employed on an equal basis, with the same conditions applying to everyone, that goes a long way to motivating employees and giving them a sense of shared value.

Use the following check point to assess your business's attitude to employing non-family members.

Check Point

The checklist below lists a number of criteria that characterise good employers. Work through the checklist and tick the relevant box in the columns on the right.

Checklist: good practice in working with employees	Yes	No	Varies
• Staff are recruited on merit through an open application process.	○	○	○
• Job evaluations for all staff are carried out using standard, objective criteria.	○	○	○
• Working conditions are as good as, if not better than, those found in non-family firms.	○	○	○
• Remuneration is made on an equitable basis and there is a transparent pay structure.	○	○	○
• Career and personal development opportunities are provided for all employees.	○	○	○
• Good individual performance and achievement are rewarded and acknowledged openly.	○	○	○
• Poor performance and disciplinary matters are dealt with fairly, by means of a formal process.	○	○	○
• All the above criteria apply regardless of whether employees are family or non-family members.	○	○	○

This checklist should have helped you to identify areas where you need to take action to improve your current practice. Note down any action points in the Action plan in Section 6.

Section 4 Development and consolidation

Topic 8 Appointing non-family managers

This topic follows on from Topic 7 by looking at issues to do with employing managers in the business from outside the family.

The need for outside managers

There are many situations where the family has to accept an outsider's role in running the business.

- The business expands to a point where the scale of operations demands additional managers.
- There is no obvious successor to the owner who is about to retire and a new management team is needed.
- There is disagreement between family members about how to run the business and outside managers are brought in to break the impasse.
- There is a lack of relevant skills and experience among family members.

The benefits of bringing in managers from beyond the family circle are that they can bring an injection of new blood into the business, and with it a range of abilities, skills and experience gained in the wider business world.

Difficulties in the family/non-family relationship

The relationship between the family business and non-family managers often comes unstuck, however. Difficulties encountered include the following.

- The new manager may have to deal with other family members' hostility towards the 'outsider' coming in to tell them how to run their family business.
- There may be a conflict of management style between the new manager and the owner-manager who is used to behaving in an autocratic manner.
- There may be a hidden agenda for employing the manager, for example:
  - to be an ally for the owner in a family feud
  - to take the role of 'fall guy' for an impending crisis
  - to act as a temporary mentor to the person nominated by the owner as the genuine management successor
  - to carry out specific unpleasant tasks, such as making jobs redundant.
- Family tensions and struggles make it hard for the manager to carry out his or her job.
- The manager is constantly reminded about not being part of the family and never being admitted into the golden 'inner circle' – opportunities for development, promotion and power will always be limited.

Activity

Read through the quote opposite from the head of a family firm.

- What are the issues in this situation?

- How could the situation have been avoided?

One of the main issues in this situation is lack of clarity about roles and expectations, especially with regard to how and when the new manager might be given a directorship. This was combined with the difficulty of having one senior manager being excluded from decision-making, when all the others were included.

Many of these difficulties can be avoided if both sides enter into the arrangement with a clear understanding of the manager's role and position in the business.

When we employed Sarah as head of marketing, she seemed to fit the bill perfectly. She had excellent qualifications and experience, and we got on very well. We had agreed the terms of employment, and talked in general terms about the possibility of a place on the board. Then came the bombshell. After two months she presented the following proposal-cum-ultimatum: in order to continue, she would have to be given an immediate directorship and shares in the company. Well, the reply was quick – I told her to clear her desk by the end of the day. On reflection, I wonder if she felt a sense of insecurity coming into the situation where other equivalent managers were family members.

Caroline, MD of family publishing firm

Helping managers into the business

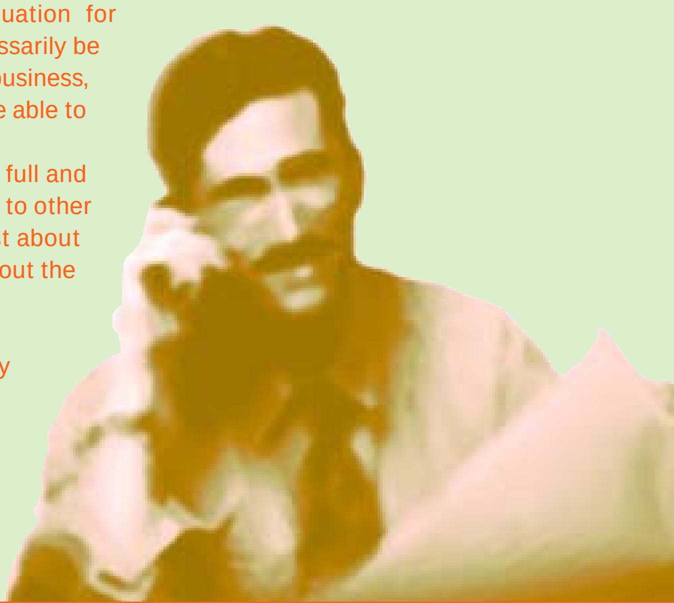
Here are some of the points that both the manager and the business owner need to agree on:

- Why the manager is being employed (are there any hidden agendas)?
- What will the manager's role and responsibilities be?
- What will be the limits of the manager's authority?
- Are all members of the family in agreement with the introduction of non-family managers?
- What procedures will be in place in case of disagreement or conflict with family members?
- What is the timetable, if any, for the manager being admitted into ownership of the business?

To agree answers to these questions, both sides have to fulfil certain responsibilities:

- 'Outsiders' coming into the business can also assess the situation for themselves, as the owners' view may be incomplete, and will necessarily be subjective. The more aware the manager is of the real state of the business, not only the finances, but also the intangibles, the better they will be able to manage.
- For their part, business owners must make every effort to provide full and accurate information to new managers, encouraging them to speak to other family members and staff. The owners need to be open and honest about their own role in the business and attitudes towards it, and clear about the role that they expect the manager to play.

In this situation, documents such as a family constitution or a family policy towards the business will be invaluable for giving new managers insight into the business they are proposing to join.



Check Point

Note down your answers to the following questions here before turning to the Action plan in Section 6.

1 What is your experience of employing non-family managers in a family business?

2 Which of the difficulties described have you had experience of yourself (from whichever side)?

3 In what ways were the difficulties resolved (if at all)?

Section 4 Development and consolidation

Topic 9 Boards of directors

When family firms start up, the direction of the business will naturally lie in the hands of the founder(s). If the business prospers and grows, the question arises of how the firm should be governed: is it still appropriate for one person or a pair of partners to keep full control, or would it be more appropriate to incorporate? This will necessitate setting up a Board of Directors. This could be kept very small, but is an opportunity to bring in outside perspectives by including independent people, not directly concerned in the management of the company. What issues does this raise and on what basis will directors be appointed?

Sharing power

Activity

Imagine the scene. It is Friday morning, 11.30 and the board of directors of Smooth Garments Ltd is about to meet for its usual hour-long monthly meeting, before heading off to lunch at the Yacht Club. What do you think are the strengths and weaknesses of this board of directors?

Ken Smooth, the Chairman and Managing Director, is ready armed with his two-page management report on the state of the business. Shirley Smooth, his wife and the Company Chairman is at his side. Simon Smooth, their son, waits obediently for his parents to sit down before taking his place. Aunt Dahlia Smooth, who has been most generous in providing funds for the business and is now in her 80s, is delighted to have her monthly outing and has had her hair done specially. She is greeted warmly by the Very Rev Dudley Pious, retired Bishop of West Anglia, who married Ken and Shirley, and is smartly dressed in Episcopal purple. Wesley Unctious, the company solicitor, arrives last and slips into his place.

Ken Smooth has clearly got things just the way he wants them. This board of directors is little more than a rubber-stamping machine, ready to accept Ken's reports with the minimum of inquiry or examination. Although it is a caricature, there are plenty of examples of family businesses setting up boards with wholly inappropriate people sitting on them, incapable of providing any meaningful input into the management process. In this case, you will have noted:

- family members with no involvement with the business and little or no experience of business matters – Aunt Dahlia may have an investment in the business, but her presence on the board is not helping preserve that investment
- family friends – brought on to the board as a favour, to further social contacts, or to make the board appear more impressive than it is
- the company's professional advisers, such as the company solicitor or accountant, may be caught in a conflict of interest.

This example raises a big issue for many family businesses: the reluctance of founders to let others become involved in the running of the business.

The main reason for having independent directors on the board is that they can contribute enormously to the success of the business by providing a stronger mix of management skills and balanced leadership.

Advantages of a broadly-based board

The responsibilities of a board of directors in a family firm include the following:

- Providing an objective perspective on matters from strategic policy to business problems
- Establishing corporate policy and help make major corporate decisions, such as selling parts of the business, mergers or acquisitions
- Mediating between family members in cases of disagreement
- Overseeing management performance
- Providing unbiased advice on questions of management succession – an area which many family businesses struggle with.

Non-executive directors

When looking for suitable non-executive directors, it is useful to have an idea of what kind of person you are looking for. It is important that such a person has the right qualities. These could include:

- expertise in business areas of relevance to the company
- business skills that complement those of existing board members
- good communication skills
- ability to be trusted by other board members
- reputation for strategic thinking
- time and willingness to commit themselves to the company.

Non-executive director (NED):

a board member with no executive or managerial responsibility for the company's operations and preferably independent of any other connection with the company. NEDs should act as a balance to executive power and bring independent judgement to bear on strategy, performance, resources, appointments and standards of conduct.

The value of non-executive directors can be assessed in terms of the roles they play and the contribution they make to the management of the business.

Role	Effect
Disciplinarian	Provides a framework to meetings and priorities.
	Focuses discussion on management strategies.
Landscape artist	Offers a 'view over the wall' into other businesses.
Devil's advocate	Suggests alternative options.
Confessor	Can be the public or private recipient of managers' concerns.
Buffer	Can say things to family members that they hesitate to say to each other.
Interpreter	Articulates the responsibilities of the management team.

Source: Stoy Centre for Family Businesses, 'Toolkit for family business'

Check Point

Note down your answers to the following questions here, before turning to Action plan 6.

- Does your own business have a board of directors?

- If so, who sits on the board and what is their particular contribution?

- What would be your ideal board of directors?

- Would it include non-executive directors? Draw up a wish list of ideal NEDs.

Section 4 Development and consolidation

Topic 10 Marketing the family business

This topic takes a brief look at issues of marketing as they relate specifically to the family business. In particular, it looks at how the qualities and strengths of family businesses help to explain their success in particular market sectors. It also looks at how the family can exploit itself as a marketing tool.

There is a complete module on marketing in the SESAME series which looks at all aspects of marketing and the small business.

Understanding the market

Family-run businesses have a major presence in all sectors of the UK economy, but their particular qualities mean that they are strongly represented in certain sectors. For example:

- service sectors – providing a service is one of the easiest ways for families to set up in business and can often exploit the perceived link between family business and high-quality, personal service
- owner-managed sectors – the personal link between the owner of the business and the customer is one of the major assets of the family business. The construction and hotel industries are good examples of this type of business.
- supply and distribution – family firms often provide the interface between larger businesses and the public, e.g. in restaurant franchises or car dealerships. The family provides the 'human face' of the industry.
- niche markets – many family businesses are built on the specialist knowledge or expertise of the founder, which is then passed down to further generations.

In short, good market knowledge is one of the strengths that family businesses possess. The best family businesses are close (and stay close) to their customers and are often quick to exploit new market opportunities. They can do this partly because they are often more adaptable than other businesses; strong family businesses can draw on the family's willingness to invest extra time and money in the business, as well as on the loyalty of a committed workforce.

There is a flipside: some family businesses may be slow to react to changes in the market, if their focus on tradition and 'the way things have always been done' causes them to underestimate the effect of even slight changes in the market, customer preferences and product development.

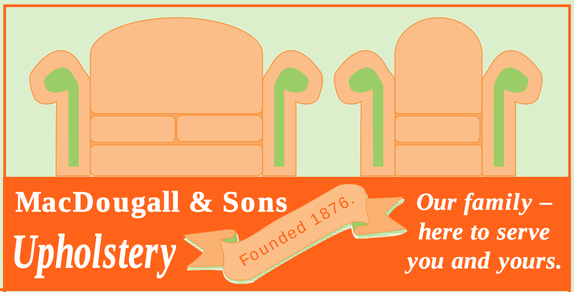
Promoting the family business

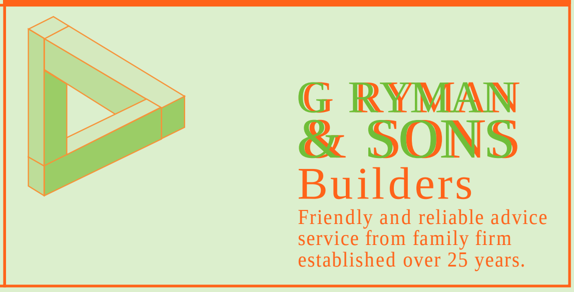
Section 2, Topic 5 looked at core values underpinning family values and suggested that, among other things, the following were key assets:

- mutual trust and co-operation
- good communication
- a belief in tradition and continuity
- a sense of responsibility towards employees and the community
- high ethical standards.

Of course not every family-run business can boast high moral standards, impressive communications and impeccable credentials as employers, but it is the case that family businesses often do pride themselves on their particular ethos. That is exactly why so many businesses are eager to promote themselves as family businesses – they believe that their family values are a strong selling point and may give them the edge over larger, more impersonal businesses.

Pride in the family business can become a strong marketing tool and many businesses are good at exploiting this. The following adverts are fictitious, but all the slogans are genuine, taken from adverts in the Yellow Pages.





Activity

Look through the Yellow Pages for your area. Find other examples of companies using their status as family businesses as a marketing tool. A good place to start looking is in the 'Builders' section.

Why do you think so many builders are keen to stress their status as a family business?

You are probably well aware that the building trade has a reputation as being fertile ground for so-called 'cowboys'. By proclaiming their status as a family business, firms are stressing their reliability and trustworthiness. This is often backed up with a statement about the length of time the firm has been established: '… established 1975' or 'over 30 years in business'.

Check Point

Make some notes in answer to the following questions before tuning to the Action plan in Section 6. There you can summarise your thoughts and plans in relation to your understanding of the market and ways of promoting your business.

- How could you use the values your family business stands for in an advertising campaign?
- Think of a few catchy slogans that could aptly describe your business and how it works.
- How could you get publicity for your business by emphasising family aspects of your firm and the values that the family brings to it (e.g. feature in local paper celebrating some aspect of the family or the business)?
- How well does your family business know its market?
- How close is it to the customer? How does it gather information about, and feedback from, its customers?
- How quick is it to adapt to changes in the market-place?
- What use does it make of market research?

Section 4 Development and consolidation

Topic 11 Financial matters – wealth preservation

In Topics 11 to 13 you will look at a range of financial matters affecting the family business, including preserving wealth, tax planning, insurance and venture capital.

The common theme of these topics is the importance of making the most of the financial resources available to you, and taking the necessary steps to keep them intact.

Preserving wealth

A key objective of all businesses is to make profit. This profit enables people associated with the business to build their personal wealth: it pays employees' wages, the managing director's bonus, the shareholders' dividend. For family businesses, the distinction between business and personal wealth is not always so clear – they need to think about where their personal wealth and the wealth of the business lie.

Who, for example, has a financial, legal or moral claim on the wealth created by the business? Is it:

- primarily the wealth of the owners/managers – because they own the business and have control over all its operations?
- the wider family's wealth – because relatives are involved in key positions or in ownership (e.g. though shareholdings)?
- also the employees' wealth – because they have invested their time and energy into it and rely on it for their own financial security?

Building personal assets

For many family firms, the business itself is the core of family's wealth. However, it is also important for the family in general, and individuals in particular, to develop an asset base that is not dependent on the business's fortunes. If this doesn't happen and your assets are all tied up in the business, then your happy retirement will depend on the next generation managing the business effectively or on your being able to find a way of translating the business assets into money, such as:

- selling the business
- selling a share of the business – either to other family members or non-family managers
- the company buying in some of the owner's shares
- partial liquidation.

Building up personal wealth partly depends on having a clear remuneration structure for family members – see Section 3, Topics 6 and 7.

Financial security can be built up by the owner(s) making cash withdrawals from the business to finance personal investment. This can be a delicate balancing act: finding a level of cash withdrawal that will enable owner(s) to make meaningful investments, without damaging the company's balance sheet.

Business assets vs personal assets

In some situations, personal assets are used to support or bolster the business, e.g. (re-)mortgaging the family house in order to provide capital, or offering property as security on a loan. This can be a high-risk strategy and the key, as with so much in the area of finance, is to get good professional advice.

This area can also be a source of resentments between people involved in the business, as the following activity highlights.

When my sister, Kelly, and I set up the temping agency, we needed an office, but because we had only a couple of years' trading, the landlord insisted on a personal guarantee from each of us on the seven-year lease. That meant that if the business folded or we didn't pay the rent, the landlord could have repossessed our houses. Our lawyer told us no court would throw us on the streets, as we both had kids, but it focused our minds on priorities: (1) pay the taxman (2) pay the rent! (3) pay ourselves.

Jane Leech, Sister Act Temping Agency

Activity

Read through the following case study and identify what the problems are in this situation. What tensions or resentments could it cause?

As well as offering personal guarantees on their offices, Jane and Kelly Leach also need a large cash investment in order to finance the purchase of equipment and cover potential cash flow shortfalls. One option the sisters have considered is borrowing against their houses. Jane lives with her partner Mike, who is also joint owner of their house, and their two children. She has tried to persuade him to agree to a remortgage, but he adamantly refuses. Kelly lives on her own with her 5-year-old daughter and already has a hefty mortgage. She feels a remortgage would leave her and her daughter very vulnerable.

There are several causes of tension in this situation. It has introduced tension into Jane and Mike's relationship. Whoever wins the argument between them, there is the danger that the other partner will feel resentful. Meanwhile, if Jane can't raise finance, then Kelly might resent her for 'putting less into the business', while she is in danger of risking everything. Conversely, if Kelly can't bring herself to remortgage, but Jane does, then Jane may be the one to feel angry.

These are difficult situations and there are no easy solutions. The key is to communicate honestly and search for fair and equitable solutions.

Check Point

Make some notes in response to the following questions before turning to the Action plan in Section 6.

Your attitude to wealth preservation

- Who, in your view, has a financial, legal or moral claim on the wealth created by your business?

- What measures are you taking to build a personal asset base, separate from the company?

- What other measures should you consider?

- Which of your personal assets, if any, are used to support the business? What level of risk are you taking by doing this?

- Finally, how satisfied are you with the level of financial advice you are receiving?

Section 4 Development and consolidation

Topic 12 Financial matters – Insurance

Insurance is one of those things in life that everyone loves to hate. Paying premiums for house insurance, car insurance, pet insurance and so on often seems like wasted money – at least when everything is fine and you don't need to claim anything on the policies. It is only when things go wrong that you can really appreciate the real value of insurance.

This topic looks at the different types of insurance that the owners/managers of business should consider taking out.

Types of insurance

In business insurance has an absolutely essential part to play in your strategy for preserving the business's and your own personal wealth. There are several types of insurance that should be considered, including:

- **Professional indemnity insurance** – to insure against being sued by a customer or client for professional negligence; this is essential for some professions (e.g. accountants, counsellors) and without it, licences to practise may not be issued by the relevant professional body.
- **Public liability insurance** – to provide protection in the case of being sued by someone (customer, client, visitor, supplier) who has an accident and injures themselves while on your premises. Again, it is essential to have this insurance covering your business premises, including your home, if that is where you trade from.
- **Insuring plant and equipment** – to insure against damage to essential plant and equipment that might interrupt the business and reduce profits.
- **Life insurance** – to provide a sum of money on the death of the owner or partner in the business, or a key manager. You may or may not need this, depending on your individual circumstances and what other people in the business would want to do after your death (see below).
- **Critical illness assurance** – a lump sum payment payable on diagnosis of a severe illness or disability (e.g. where someone has a stroke and survives, but is unable to continue working); the money can be used to pay off mortgages, overdrafts or other loans.
- **Permanent health (long-term disability) insurance** – to provide a regular income in the case of someone becoming unable to work through illness; this is often used in conjunction with critical illness cover, so that the lump sum from critical illness cover meets immediate financial needs, while the permanent health policy provides an income for as long as it is needed.

Life insurance

Death is not everyone's favourite topic of conversation, but in the case of family businesses, it simply shouldn't be avoided. What would happen if you, or your business partner, or a key manager were suddenly to die tomorrow? Would the business survive? Would the people left behind want to carry on with it? If so, would they be able to financially?

Life insurance is a flexible way of easing financial problems in the case of the untimely death of the owner or partner in the business. It can:

- guarantee the financial security of a surviving spouse, e.g. by paying off any outstanding mortgage or business loans
- be used to provide the funding for a family share purchase agreement
- solve inheritance difficulties, e.g. by providing cash legacies to heirs not involved in the business, while shares provide a comparable legacy to those who are active
- compensate the business for losses arising as a result of the death of the owner – so called 'key person' insurance – for example, by repaying loans or overdrafts.

The crucial point to remember when taking out life insurance is to have a clear idea of what the insurance is needed for. Remember: life insurance is a way of providing *for other people* on your death, unlike critical illness and permanent health insurance, which are ways of providing *for yourself* if you should become incapacitated.

Activity

What would happen to the business if you – or your partner or a key manager – were suddenly to die?

How far have you prepared for this unpleasant possibility? Has this been discussed?

My husband and I run a small family hotel in the country. This has also been our family home and the mortgage will be paid off in five years' time. The outstanding amount is comfortably covered by a combination of endowment policies and other investments. We discussed what would happen if either of us died and whether we needed additional life insurance, but basically we decided that neither of us would want to carry on this particular business after the other's death – the surviving person could either carry on living here or could sell up and buy something smaller. Being self-employed, we do have critical illness cover and permanent health insurance – in case the other person had a disabling accident or got ill. And of course we have public liability insurance, in case one of the guests gets tangled up in the water wheel!

Mike and Poppy Rowlands, proprietors of a country house hotel

Check Point

Think about how well covered you and your business are in terms of insurance. Complete the following table by ticking the relevant columns.

How about other people in the business? Are they fully covered?

	Already have	Don't have	Definitely need	Might need	Don't need
• Professional indemnity insurance	○	○	○	○	○
• Public liability insurance	○	○	○	○	○
• Insuring plant and equipment	○	○	○	○	○
• Life insurance	○	○	○	○	○
• Critical illness assurance	○	○	○	○	○
• Permanent health insurance	○	○	○	○	○

This checklist should help you identify areas where you need to take action to improve your insurance cover. Note down any action points in the Action plan in Section 6, Topic 4.

Section 4 Development and consolidation

Topic 13 Financial matters – Tax planning and venture capital

This topic continues with the theme of managing finances with a look at two separate areas of family business finance: tax planning and venture capital.

Tax planning

There are several aspects of taxation that business owners and managers have to think carefully about:

- taxation of *income* during the lifetime of the business or the working life of the family member in the business
- taxation of *capital gains* when assets (such as shares in the business) are transferred either as lifetime gifts or following the death of the owner of the business
- taxation of a person's estate on death through *inheritance tax*.

Aspects of income tax were covered in Section 3, Topic 5 – especially the different methods that are available for paying yourself and the tax implications of doing that.

Capital gains and inheritance taxes are looked at in Section 5, Topic 15, as they form part of retirement planning. However, the importance of planning early cannot be stressed too much and so, even if retirement seems ten years or more away, you should already be thinking about it. Again, the most important thing is to ensure you get good professional advice.

Venture capital

There are many sources of funding available to small and medium-sized family enterprises. These include:

- internal funds – raising money within the family or within the business
- debt – taking out a loan or overdraft
- external equity – receiving funding from an external source in exchange for a share of the business (venture capital).

Research commissioned by the Stoy Centre for Family Business into family businesses' attitudes towards finance has found that the preferred source of funding for family businesses is internal, with venture capital being their least preferred. The research found that less than 1% of family businesses used venture capitalists as a source of funding, compared to over 25% of non-family businesses (Stoy Centre for Family Business (2001), p. 3).

What is venture capital?

Venture capital (also known as risk capital, investment capital and development capital) provides high-risk or small companies with long-term, committed, risk-sharing capital, usually in return for an equity position in the firm, i.e. a significant shareholding. This makes it an altogether different proposition from, say, a bank loan, where the bank has a legal right to interest on a loan and its repayment, irrespective of the company's success or failure. With venture capital, returns are contingent on the growth and profitability of the company.

Uses of venture capital

Venture capital is often used to help new or recently started businesses develop and expand. It also has a role to play in situations where the founder/owner of a business wants to retire or sell the business, and there is the possibility of a management buy-out (MBO) or a management buy-in (MBI). Both these situations can offer the venture capital backers considerable capital growth prospects.

Issues in using venture capital

The main issues for British owner-managers when questioned by Grant Thornton about the possibility of using equity finance were:

- 'Would outside shareholders change the way I run the business?'
- 'If I introduce outside shareholders, how greedy will they be?'

This highlights the fears of owner-managers about losing independence and control as they consider options for expanding the business. This is perhaps not surprising, given the nature of family businesses and the entrepreneurs who found them: the family orientation of the business and the sense of continuity and pride in the business may be crucial to them.

Other concerns expressed by owner-managers about using external sources of funding include pressure from outside to meet targets and pressure to change the management team. There is also the 'fear of the unknown' and the suspicion that venture capitalists are a different breed of creature from family entrepreneurs.

The Stoy Centre research also seemed to confirm the notion that owner-managers of family businesses and venture capitalists might have different – and contradictory – objectives. For example, venture capitalists might be most concerned with profitability and growth, whereas the owner-manager might have other motivations, values and objectives, as discussed in Section 2.

It is nevertheless true that that external funding can provide family businesses with the best route to expansion and growth, or can provide the means for passing the business from one generation to the next.

43% of family businesses questioned felt that they weren't confident with the rules of the venture capital game – this compared to only 27% of non-family companies.
Stoy Centre for Family Business (2001)

Check Point

Think about these questions before turning to the Action plan in Section 6 to summarise your thoughts about tax planning and venture capital.

Tax planning

- What measures for tax planning do you currently have in place?
- When did you last review your plans with your taxation adviser?
- What additional steps could you consider taking?

Venture capital

- What is your attitude to venture capital? Do you share the mistrust of many other family businesses?
- Can you identify areas where venture capital could provide a much-needed injection of funds into the business?
- If so, in what ways might that capital help the growth and development of the business?

Section 4 Development and consolidation

Topic 14 Family business, family conflict

Conflict is a fact of business life. The Head of Admin may have an ongoing argument with the Managing Director about direction and policy. The Sales Manager may feel her department is under-resourced. The Head of Finance may feel resentful that he doesn't have a seat on the board. Rumours are flying about the MD's Personal Assistant and the Head of Distribution, and morale has slumped in the warehouse.

Office politics can be unforgiving at the best of times, but when the players are siblings, parents and spouses, then the stakes are raised even higher. This topic, along with Topics 15 and 16, looks at the kinds of conflicts that can arise in family businesses and what can be done about them. It also looks, in particular, at how personal relationships can interfere with business.

The family firm: a battleground?

The following activity will get you thinking about the types of conflict that family businesses have to deal with.

Activity

Read through the following five case studies which describe what happens when members of family firms come into conflict. For each one, describe:

1 what lies at the heart of the conflict
2 how the conflict could have been avoided
3 what could be/could have been done to resolve it.

1 Westman's Brewery

Westman's Brewery was started by Jack Westman's father, who set up a brewery in Gloucestershire and gradually built up a network of nearly 50 rural pubs. The shareholding of the estate was divided between Jack, his younger brother Christopher and his sister Lorna. Jack and Christopher held 40%, Lorna the remaining 20%. Jack was managing director while Christopher looked after the wines and spirits division.

Jack carried on the altruistic policy of his father, who vowed never to make anyone redundant and to pursue a programme of charitable giving and community initiatives. During periods of financial difficulty, Christopher and Lorna argued vigorously against this policy, but Jack would not be swayed. Eventually, Christopher and Lorna decided to sell their shareholdings. The valuation they received was higher than Jack thought he could afford without rationalising the business. There then followed an acrimonious two-year legal battle which split the family in two.

Based on a case study in Rock, S. (1991) *Family Firms*, Director Books, pp. 60-1.

2 Charterhouse Ltd

Charterhouse Ltd is a firm of electronic publishers, set up by James Charterhouse in the early 1970s. James and his wife, Wendy, were the original directors, although Wendy has never had any role in managing the company. James is Chairman and Managing Director. His brother, Alex is in Managing Director of Charterhouse Inc, the American sister company. James and Wendy together form majority shareholders of both companies.

Alex resents Wendy's role in the business, especially her shareholding in Charterhouse Inc. The tension in the business led to bitter arguments and it become impossible for Alex and Wendy to be in the same room together without arguing. James supported his wife to the hilt, and his relationship with his brother deteriorated. Accusations became more personal, with old family issues raked over. Eventually Alex resigned from Charterhouse Inc. joined a rival company as a director and took several important clients with him. James is currently suing his brother for breach of contract and copyright violation.

3 Plas Newydd Guest House

When Huw Williams bought the Plas Newydd Guest House, this was partly to solve the housing problem of his wife's parents, who had got into financial difficulty and defaulted on their mortgage. His mother-in-law, Mary, runs the bed and breakfast side of things, dealing with inquiries, organising cleaning and making breakfast.

Mary has had poor health recently, and has called on her husband Neil for help, but he doesn't want anything to do with the guest house. There have been several arguments, mainly between Huw and Neil, some of which have spilled over into the actual guest house so that guests could hear the shouting. In the most recent argument, when Huw threatened to sell the guest house, Neil (who had been drinking) struck him.

4 When Sharon married Dev Bhattacharya

When Sharon married Dev Bhattacharya, they were both students at London University. Sharon went on to become a solicitor, while Dev worked in the city for a while, before deciding to join his family business, which involved providing serviced office accommodation for small businesses in various locations in north London.

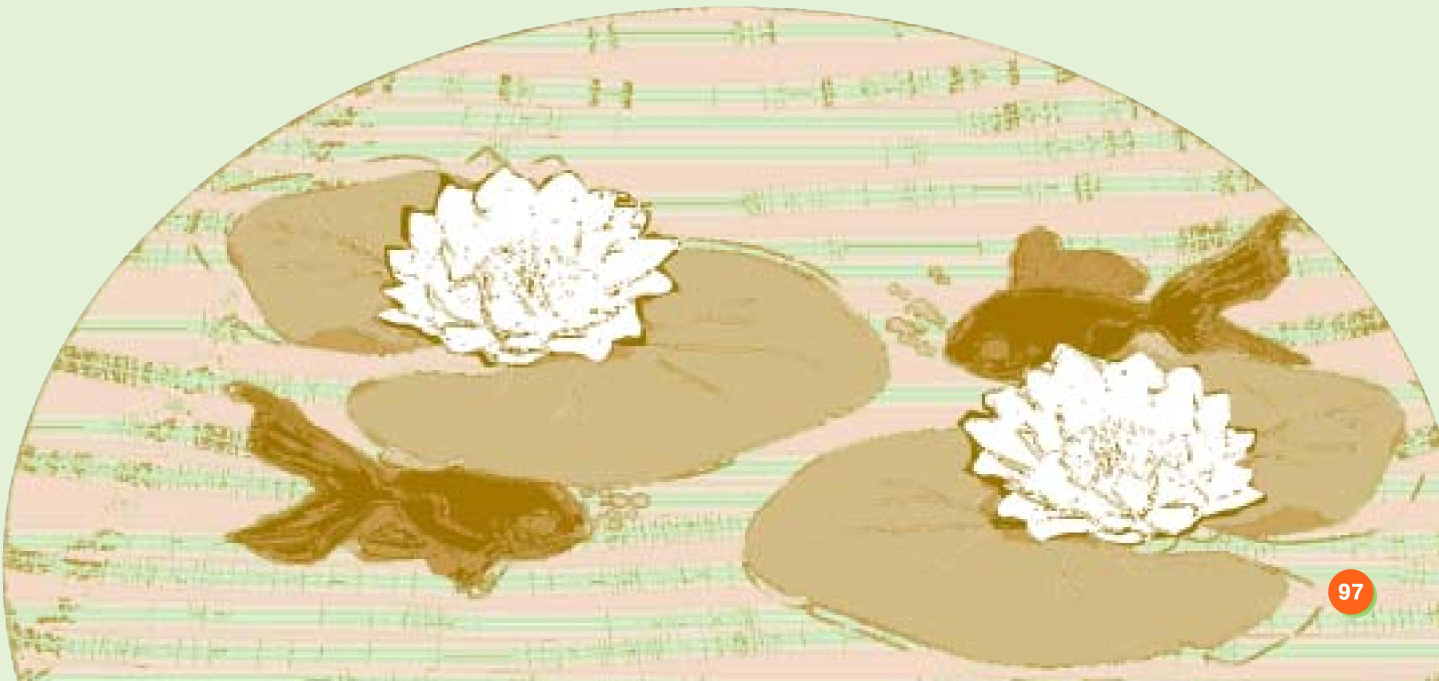
The birth of their second child coincided with the retirement of Dev's uncle from the business, so that Dev was promoted to a senior management position. His workload gradually increased until it got to the point where Sharon felt she was bringing up two children on her own. When she tried to talk to Dev about it, he said he had to work that hard – it was expected of him and besides he was providing for their future. Sharon went to talk to Dev's father about it, who said it was a matter for the two of them to sort out between themselves. In their most recent argument, Sharon gave Dev an ultimatum: he either had to leave the family business or she would leave him.

5 Alex and Janette Farmer

Alex and Janette Farmer successfully ran their business supplying and building all kinds of water features and ponds. To begin with, all was fine – the business was a success and gave them a comfortable standard of living. Gradually, however, they started drifting apart, developing separate interests in their personal lives, and seeing less and less of each other outside business hours.

It finally came to a head when Janette started a relationship with Alvin, one of the contractors who did some of the landscaping. To begin with, Alex and Janette tried to keep the business going – but found it impossible to work together. Every minor difference became tinted with personal grievance, to the point where Janette felt she couldn't make any decision without the possibility of Alex criticising it and using it to point out her failings as a wife.

The next topic looks at some of the issues arising from these case studies and suggests some courses of action to avoid/deal with this kind of conflict.



Section 4 Development and consolidation

Topic 15 Causes of conflict

This topic carries on the theme of conflict, started in Topic 14. You will explore some of the issues raised by the case studies described in the last topic. In particular, you will look at how personal relationships can interfere with business.

At the heart of the conflict

The five case studies in Topic 14 illustrate some of the reasons for conflict:

- disagreements about the nature of the business, e.g. its purpose, goals and objectives, its orientation (family vs business), or its direction – this lies at the heart of the problems that beset Westman's Brewery
- translating business disagreement into personal conflict – as occurred in several of these examples: Charterhouse Ltd, the Caledonia Guest House, the Farmers' pond business
- using the business as a battleground to play out family conflict, e.g. rivalries between siblings, parents and children, or other family members – e.g. between the Charterhouse brothers
- feeling of exclusion among family members not included in the business, e.g. spouse who feels excluded from family business and tries to prise partner away from it, either emotionally, financially or in other ways – the case with the Bhattacharyas.

This list is by no means exclusive, but does highlight some of the main issues that can cause conflict. A common motif is the difficulty of drawing clear boundaries between family life and business life, so that when conflict arises, it all too often spills over from one area into the other.

Business differences

Differences about the nature of the business can become so acute that they threaten the business itself, as in the case of Westman's Breweries.

For this reason, having agreement – stated openly – as to what the business is about is of prime importance. This depends on reaching a common understanding of the values and goals of the business, and how they tie in with the values and goals of the family. (This is covered elsewhere, notably Section 2, Topics 6 and 7, and this section, Topics 1 and 2.) Of course, things will change over time, but an original common agreement will act as a bench-mark against which to measure things.

Sibling rivalry

Problems between siblings are one common form of conflict in family-run businesses. Rivalry in business is often an extension of childhood rivalries, where brothers and sisters may have competed for parents' time and attention, or fought over toys and possessions – even over the same girlfriend/boyfriend. Psychologists believe that some sibling rivalry is inevitable and boils down to a battle for parents' love and affection.

> **My sister and I have fought like cat and dog since we were children. We are like chalk and cheese, and always rubbed each other up the wrong way. As children we sat round the dinner table and squabbled. Now we sit round the boardroom table and squabble. If it wasn't so pathetic, it'd be funny.**
> **Neil, director of a family business**

Part of the difficulty is the fact that it is hard to achieve 'equality' in sibling relationships: one child will have grown up as the oldest child – bigger and stronger than the younger siblings. The oldest child may have been used to getting their own way, or conversely, may have taken a protective attitude towards the younger children. It may be that the oldest child has been groomed as the natural heir to the business.

For younger children, the fight to establish individuality and independence may show itself in a desire to carve out a clear personal role in the business, to prove to everyone else that they are just as good as their older brother or sister.

Sibling rivalry may be made worse if it is tacitly encouraged by the older generation, e.g. by the father or mother who is the current owner/manager of the firm and regards the children's rivalry as healthy for the business, either because it 'keeps them on their toes' or because it prevents them forming an alliance that could be threatening. Parents may regard this kind of rivalry as a way for the most able and assertive successor to come to the fore.

Parent–child rivalry

In practical terms, parent–child rivalry most often comes down to conflict between fathers and sons. Studies of family businesses have found that father–daughter relationships in business are relatively trouble-free, whereas the father–son relationship tends to be fertile ground for dispute. However, this may simply be that women's role in business a generation or two ago was rather different from what it is now – the majority of businesses were set up and controlled by men, and if the business was passed on, it was usually to a male heir.

Some of the key problems that have been identified are:

- parents resisting giving up control of the firm, long after they have reached retirement age.
- parents finding it hard to be sidelined by their children and guarding power jealously.
- in order to maintain control, parents making decisions in a secretive way and refusing to delegate authority.
- children feeling sidelined and even humiliated – made to feel like a child, not an adult.
- children feeling torn – between expressing their independence on the one hand, and being loyal and obedient to their parents on the other.

> **The most important thing I have learned – and the one piece of advice I'd give – is that if you know there's a problem, don't delay! The worst thing you can do is ignore it – but that is just what a lot of families do, simply because it's easier than facing up to the real issue.**
> **Inge, family therapist**

Section 4 Development and consolidation

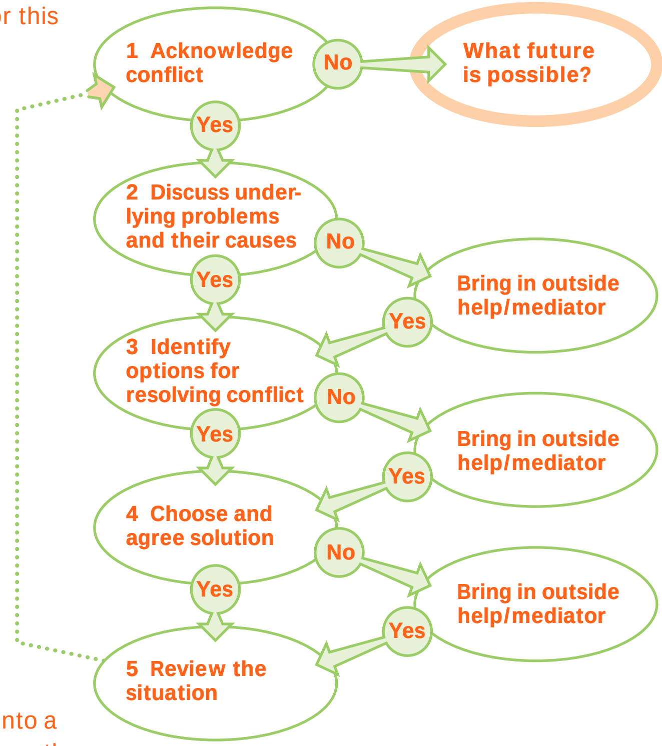
Topic 16 Dealing with conflict

In this topic, you continue the exploration started in Topics 14 and 15 of conflict in family businesses. Here you will look at ways of finding solutions to conflict.

Seeking solutions

Any conflict can have a negative and destructive effect, not only on the business, but also on the individual and the family. For this reason, it is imperative that a way is found to deal with it.

The flowchart outlines a possible route to resolving conflict.



Ward, J.L. (1987) *Keeping the Family Business Healthy*, Jossey Bass Publishers, p. 98

Step 1: Acknowledge the conflict

The first step is to acknowledge that the conflict exists! This may be stating the obvious, but it is amazing how long families and businesses can find ways of living with conflict without ever actually bringing it into the open.

There may also be a difference in perception: one side feels that the conflict is causing great damage, while the other refuses to acknowledge that they are part of the problem.

Some families may not get past this first stage. If there is an unwillingness or refusal to face up to the problem, the question is: what next? At this point, some people will just go on living with the conflict, although this is a recipe for disaster, as seething discontent threatens to boil over into a final meltdown. Some people choose to opt out, giving up on the business altogether.

Step 2: Discuss the problem and its causes

All parties involved in the conflict must start talking to each other about their feelings and behaviour in order to try to prevent the situation from becoming destructive. Communication, as with so many aspects of business, is vital. Part of this communication involves searching for the causes of the conflict. These may go back long into the family's history and it is important that this discussion doesn't become a slanging match or an excuse to indulge in settling of old scores.

It is often useful to involve a third party in the discussion. Someone regarded by both sides as independent can not only bring an objective view to bear on the situation, but can keep discussions focused. Their very presence may prevent discussions getting out of hand or too personal. This mediator could be:

- a family member trusted by both sides
- a business friend or colleague
- a specialist mediator or counsellor.

Sometimes the focus of the disagreement is changed to a dispute about who should mediate. Thus, it can help if this has been agreed previously, e.g. in a family constitution (see Topic 3).

Absolute honesty is required – and family members also need to recognise that this is the case. If the family can't cope with the level of honesty, then it falls at the first hurdle.

Step 3: Options and solutions

The third step is to start identifying options for solving the problem. Simply accepting that there are ways of tackling the problem can be a liberating feeling and can generate the will to find a solution acceptable to all sides. Options might include:

- making changes to shareholders or partnership agreement
- clarifying roles and job descriptions
- setting up systems for improving communication.

For example, one way of dealing with rivalry might be to find separate, but complementary, roles for people in the business, reducing the potential for competition. If the family business is large enough, siblings could take responsibility for separate areas – whether operational or geographical (or preferably both). Another common way out of sibling rivalry is for the family to bank-roll one of the children (typically the younger) in an independent business venture in order to prove themselves.

Step 4: Choosing and agreeing a solution

Once options are on the table for solving the problem, the process of negotiating an agreed solution begins. Once again, the presence of an independent mediator may be extremely useful.

At this stage, each party needs to acknowledge that resolving conflict may involve some compromise. Conflict doesn't have to mean that there is one winner and one loser. If the family can face up to conflict and make real efforts to deal with it, it can emerge stronger than before for having worked through the process. In short, everyone is a winner – above all the business.

Step 5: Review the situation

Once a solution has been agreed and implemented, it is important to come back and review the situation at agreed points. If the solution doesn't work, it may be necessary to work through the process again …

Check Point

Think about how conflict has affected your business by making brief notes here. Then summarise your thoughts and ideas in the Action plan in Section 6.

- What are the conflicts in your business?

- What lies at the heart of them? What are the underlying causes?

- How can these conflicts be resolved? What are the options for solving the problems?

- Who needs to be involved? How can the process be set up?