Family Business Australia

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"our families mean business"

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Parliamentary Joint Committee on Corporations and Financial Services
Parliament House,
Canberra.

Inquiry into shareholder engagement and participation

From Family Business Australia

We are pleased to attach an outline of Family Business Australia's 'Best Practice', as requested by the Committee.

These principles are centred on the three systems of family business – the family, the business and the ownership group – and the means by which they might most effectively interact. The associated dynamics are fundamental to the Committee's Inquiry; in particular, the interaction between the ownership group and the business.

We submit that just as most families are private, so are the businesses they own. That privacy is reflected in the pre-emptive right provisions of most family company constitutions, which, in our view is the aspect which most clearly distinguishes those businesses from companies which solicit ownership by the general public, including institutional owners. We believe the pre-emptive right provision should be given high regard as a defining principle for legislative review or reform.

We hope that the Committee will consider our perspective and in doing so, consider the merits of broadening the scope of the legislative framework to allow family businesses greater discretion to seek members' determination of the manner in which the business and the ownership systems interact. We have specifically referred to legislation which we believe requires amendment consistent with this principle.

Such an approach is consistent with the fundamental principle that the business should serve the best interests of all members. We also contend that provisions should be retained which protect minority interests against oppressive action.

The broad objective of our submission is to bring to the Committee's attention the magnitude of the family business sector and to encourage reform intended to enhance its contribution to the economy through more effective engagement of family business owners, especially those not involved in the operations of the business.

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Family Business Best Practice

The term 'best practice' generally refers to the best possible way of doing something. Family Business Australia holds that best practices are tools, not rules! It is incumbent on each family in business to select those practices that are right for their family business at that particular stage of its composition and development.

The ownership structure of the business is particularly relevant since it is usually the ultimate determinant of effective power and control, and generates both the key management issues and the leadership and ownership succession challenges. Three main ownership configurations or stages can be identified: controlling owner; sibling partnership; and cousin collaboration.

The main objective of focusing the attention of families in business on 'best practices' is to encourage them to anticipate and prepare for the next stage(s) of development of their family business, as well as to consider the after-effects or consequences, on the business and the family, of any decisions taken at any stage.

The adoption of appropriate 'best practices' can make 'great' family businesses out of 'good' family businesses.

Employing family members: One of the major issues that family businesses grapple with is how to bring members of successive generations into the family enterprise. Successful family firms structure well-designed and customised employment policies early in the life of the business.

Best practice principles demand that should a position became available, it would be advertised, and not automatically be given to the family member wanting to join the business.

The family business literature suggests that outside management experience for family members (or their partners) before they join the family business is highly recommended. Family members (or their partners) who have had the opportunity to prove themselves before they join the family firm have a greater chance of feeling they have received adequate preparation for their role. This is likely to be manifested by a sense of accomplishment and self-confidence as well as bringing a broader perspective, new skills, fresh ideas and flexibility in the face of business challenges.

Remuneration principles in the family business: Whilst there are no foolproof compensation formulas, the existence of rational, systematic compensation policies that communicate a clear understanding of the value of various family business jobs ensures that the business remains competitive by encouraging family members (and other employees) to work for what is best for all. Creating a compensation policy involves deciding on a philosophy of compensation that emphasises positive values, determining the market value of particular jobs, negotiating personal goals and pay incentives, and establishing criteria for assessing performance. Factors to take into account include: position and degree of responsibility, type of industry, size of business, number of people supervised, sales or revenue volume, cost of living based on location, and business profitability. The challenging issues of open, disclosure and transparency also need to be adequately addressed.

As is the case with employment and compensation policies, well-designed and customised policies to guide career planning and development decisions, put in place before the need arises and communicated widely, enable families in business to make considered and timely decisions over

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the years with many potential positive benefits and outcomes. Relevant questions include: Are the policies based on the principle of merit? Do they focus on competence and earned privilege and discourage paternalism and nepotism in the business? Are they designed to attract, promote and retain the most competent, including talented outsiders?

Communication, governance and outside advice/input: Family meetings (preferably held around the boardroom table rather than the kitchen table) are one of the most important steps a business owner can take to ensure the continuity of the family business by building stronger families and stronger businesses. Properly convened and managed, family meetings help family members (and their partners) to recognise, discuss and resolve conflicts before they become crises. They challenge family members to communicate and face their differences rather than avoid or ignore them. They also help younger family members to appreciate important family values, traditions, and history; as well as the entrepreneurial nature of wealth creation.

Family meetings can also be used to: open up discussions concerning the succession process; to instil principles of 'stewardship' and 'understated wealth' in the younger family members; to professionalise the business and (where applicable) to manage relations between the family and board of directors.

Family meetings have the potential to bind the family and the business particularly during difficult times. These meetings also provide younger family members with opportunities to develop and display leadership, conflict resolution, and sound communication skills and to learn how to manage meetings.

Boards: Establishing a board of directors that includes suitably qualified and independent non-family members is a way to professionalise ownership and management responsibilities in the family business, and introduce a measure of accountability.

An effective board is an important forum for discussing ideas, planning the future direction of the business, and developing short and long-term survival and success strategies.

Where the family does not wish to create a formal board of directors or share decision-making power with them, it might consider as an alternative the formation of an advisory board made up of a small group of knowledgeable and experienced professionals

Charter: A family Code (of conduct) is a document that guides the overlap between family and business values. It specifies the relationship between the family and the business, and sets out guidelines for resolution of issues and how the business is to be managed. It reflects family and business values, and formalises the procedures and relationships between family members and the business. The family code can be very important in multiple generation enterprises where patterns of relationships are seemingly more complex. It can then be geared towards maintaining harmony and co-operation, and preventing conflicts. As a policy document, the code outlines procedures for dealing with those issues considered to be the most conflict ridden and critical to the future of the business. The code can cover any number of areas and each is unique to each family business.

Family council: For the more complex family business involving several generations and numerous family members (some active in the business and some not), a family council (of key family members) would be one of the avenues for discussion of important family business issues. It can serve as a buffer between the family and the board of the business so that the board does not have to deal with all matters concerning the family, addressing only specific issues that are referred to it by the family council. Formalising a family council helps to establish a clear boundary between the family and business.

The family council provides a forum for reaching consensus and for communicating family policy on business issues that might impact family members, such as compensation, employment criteria, voting rights, obligations of shareholders, and the pricing or terms of buyback provisions in shareholders' agreements. It is also a venue that offers family members an opportunity to share their views, interests and goals; to understand family business policy; and debate issues of common interest. Family members can raise concerns with others and deal with important and sensitive issues that are likely to create differences and stir up strong feelings.

Agenda topics for a family council include: developing a clear and powerful family vision or uniting common purpose; defining personal goals; addressing issues of fairness; developing a shareholders' buy-sell agreement; establishing successor leadership criteria and successor leadership development programs; defining ownership guidelines and employment rules; and developing a family business compensation system. These and similar items could be incorporated in a family code.

Planning: While business challenges will differ in every business, family challenges are often the same in every family. Establish what the challenges are then outline what steps have already been taken to address them or what steps you plan to take.

The process used to develop the plan is important with regard to: the people who were involved, whether external advisers were consulted, and how it demonstrates a spirit of enterprise. Does the plan incorporate a strategy based on both smart and wise growth, i.e. one that links the needs of family, ownership, management, and individuals together in a forward-driving growth momentum?

Key members of the business need to be aware of this plan.

Business continuity and succession: For business owners who want their businesses to continue in family hands, succession is a main concern and challenge. It has been described as their 'final test of greatness'.

Succession (or business continuity) planning is a process designed to ensure the continuity of the business through the generations. It is never too early to plan for family business continuity.

A comprehensive succession plan includes: developing a strategic plan for the business; a contingency and risk management plan; personal financial and estate plans for current owner-managers to ensure that retirement is adequately funded; a shared vision or uniting common purpose (that articulates the family's commitment to perpetuate the business as a family owned/managed enterprise); and personal and leadership development plans for potential successors to ensure they are both willing and able.

In the event of that there are no eligible family successors, there needs to be a plan to develop employees in the business to assume senior positions at some stage.

Communication with all key members of the business and the family is a good idea. The family business literature suggests that succession should be a process rather than an event!

Carefully considered, and suitably tailored, leadership training and mentoring programs can inspire and assist younger family members to acquire specific business knowledge and skills, develop as individuals, exercise judgment, take risks, and accept a commitment to relate to people in an empathic way. They can also provide an education in responsible and/or active ownership.

To enable younger family members to ask difficult questions and to appear vulnerable if necessary, it may not be appropriate for the successors' parents or bosses to be the initial mentors.

One or more trusted professional advisers or non-family directors who know the business, the family, and the younger family members may be able to develop informal and confidential relationships (based on personal affinity) that exist primarily for the benefit of potential successors.

One of these relationships could help younger family members to become more proficient in their job areas, and the other could assist successors with 'big picture' issues and challenges.
