

One Family Business – Two Succession Challenges

PEMBERTON  GREENISH

Statistics have for many years shown that a depressingly low percentage of family businesses survive beyond the third generation. In many cases this can be from lack of forward planning and, in particular, an unwillingness to face up to creating a succession plan.

So what needs to be done to ensure a smooth transition of the business to the next generation?

Family businesses are extremely important to the UK economy. A report prepared for the Institute for Family Business by Capital Economics in February 2008 estimated that family businesses:

- account for around 42% of private sector employment
- account for around 38% of GDP in the private sector and
- pay around £47 billion per annum in taxes to the Exchequer.

Why should succession be such a thorny issue?

The first point that needs to be made is that there are two types of succession, management succession and ownership succession – and each needs to be considered carefully and planned in advance.

Management Succession

A family member who is running a family business should be asking himself (or herself) a number of questions, such as:

- who will run the business after me? family or non-family?
- if family, which family member?
- who judges the most appropriate successor? Am I necessarily the right person or should I be consulting one or more third parties, for example any non-executive directors on the board or third party consultants?
- are the next generation capable but not yet old or experienced enough to manage? If so, do I need to recruit a non-family member to run the business until they are ready, when hopefully it will become clearer which member of the next generation should lead the business?

- what further support, training, and/or experience do the next generation need in order to succeed as managers?
- if there are no non-executive directors on the board, should I be appointing one in order to provide guidance for the next generation?
- should I be managing my retirement in stages through a gradual reduction in hours?

Chief executives of family businesses often find it difficult to let go and questions such as these tend to be considered too late in the day. In some cases this can threaten the survival of the business and so planning an orderly succession is absolutely vital.

Ownership Succession

When a family business is in its early stages, ownership may be relatively straightforward, with the shares typically being held by the founder or founders and possibly their respective spouses. All or a substantial majority of the shareholders will typically be working in the business.

However, as the family grows and new generations emerge, the owners will need to consider a number of questions:

- who do I want to inherit my shares?
- should they be gifted or sold and, if sold, how should the price be calculated?
- am I happy for the next generation to be entitled to the income from my shares but concerned that they should not yet have control of the business? If so, should I be thinking of having different classes of shares and/or putting all or some of my shares in trust?

As further generations emerge and the business becomes more established, with not all family members working in the business and perhaps non-family executives involved in management, ownership can very quickly become fractured and further questions arise:

- should shares be regarded as a capital investment which can be sold or as an asset to be passed on to the next generation?
- what should the general policy be on ownership of shares?
- should ownership be restricted to bloodline family members or even to bloodline family members working in the business? If the latter, how will family members not employed in the business be “compensated” for their lack of shares?
- should in-laws or non-family executives be allowed to own shares? If yes, what happens if

the marriage fails or when the employment ends?

There are not necessarily any right or wrong answers to the above and families will have different views.

However, what is important is that these matters are considered by the family and an agreed policy is set out in the Articles of Association, a shareholders’ agreement or a family charter. As in the case of management succession, forward planning is essential.

In the next edition of PG Lore Andrew will look at Family Business Governance and Family Councils.



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