

CAN A FAMILY BUSINESS SURVIVE FOR GENERATIONS?

Family Businesses struggle to survive for many generations for the primary reason that the family members grow faster than the Family Businesses. With each generation the members of the family grow with the founder of the Family Business having children and grandchildren, and the Family Business does not have enough cash flow or capital to support or finance the increasing number of new family members.

Some of the family members are owners of the assets of the Family Business only and not employed by the Family Business (“inactive members”). Other family members are merely employed by the Family Business (“active members”) and not owners of the assets of the Family Business. While other family members are active members and also owners of the assets of the Family Business. This dynamic of a Family Business often creates a scenario where the interests of the different family members are not aligned. The active members often have a vision of long-term investment to build and grow the Family Business, while the inactive members often have a private equity investment outlook for the Family Business by looking at the short-term investment returns.

The Family Business must adopt a family constitution to ensure that the interests of the active and inactive family members are aligned and to ensure that the vision, aims and the objectives of the Family Business are defined. The family constitution must also regulate how conflict within the family business must be adjudicated. The family constitution must also define (and regulate) the leadership responsibilities within the Family Business, the roles and responsibilities of all parties in the Family Business, the remuneration policy of the active members of the Family Business and various other aspects.

Active members of a Family Business often earn lower than market related salaries because the Family Business have limited cashflow and/or the family is willing to rather invest the excess cashflow into the business. Conflict in a Family Business is often present in these circumstances as the active members feel they are working hard for the benefit of their siblings, without receiving the personal reward for their hard work.

It is also very important for the active members in the Family Business to build up their savings outside of the Family Business and to become financially independent from the Family Business at some stage. Family Businesses are often divided or depleted from capital, because it has the burden of paying capital to the retiring generation when the younger generation take the reins of the business. If the Family Business pays market related salaries to the active members, they can have capital and savings to provide for them after retirement, with no (or a lesser) burden or obligation on the Family Business to distribute capital to them when they retire from the business.

The Family Business must also protect itself from various other risks, like divorce, estate costs and insolvency/liquidation. This can be achieved by doing thorough planning and setting up legal entities and structures as owners of the Family Business and its assets. Divorced spouses and creditors would then not be able to institute claims against the Family Business or its assets. The operational activities in a Family Business must also be done in a legal entity which is separate of the assets of the Family Business, to ensure that the assets of the Family Business would not be exposed to the operational risks of a business. By doing ownership planning in legal entities the family can also ensure that the value of the Family Business and its assets would not be exposed to estate duty or capital gains tax when the Family Business is transferred to the next generation.

Family Businesses are well known for its resilience, culture of hard work and long-term growth of its intrinsic value. This can be achieved if the Family Business is regulated by a family constitution which creates a uniform and shared vision and a vehicle for good and regular communication between all members of the family.