Newsletter

BURGES SALMON

Family Business

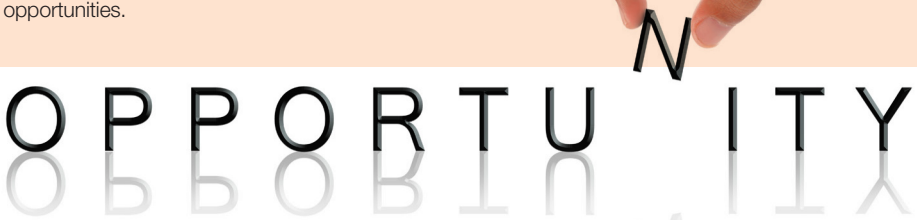
July 2015

Welcome

Welcome to the latest edition of the family business newsletter. In this edition we look at what a growing economy means for the family business and also summarise some legislative changes currently being implemented that will affect all companies.

Planning for Growth

Family Businesses are often praised for their ability to take a long term view, building the business prudently and having the strength to weather even the most adverse parts of the business cycle. However, in a growing and fast moving marketplace it is equally important that family businesses retain their ability to act quickly and seize new opportunities.



Caution vs performance

In an article ("What you can learn from Family Business") published in the Harvard Business Review in November 2012, the author summarised one key difference between family and non-family businesses as follows "family businesses focus on resilience more than performance. They forego excess returns available during good times in order to increase their odds of survival in bad times." The article concluded that there is much that non-family businesses should learn from this.

However, while concept of "patient capital" has obvious advantages it is also clear that a key challenge facing family enterprises is that of maintaining the entrepreneurial zeal and energy to compete in a rapidly changing market place. This is not to suggest that family businesses should (or would necessarily want to) adopt a more adventurous risk profile. However it is probably true to say that any family organisation can be resistant to change and can easily become stuck in a rut of doing things "because this is the way we have always done them".

This newsletter looks at a number of ways in which family businesses might make small changes with the aim of enabling them to adapt more quickly and take advantages of opportunities for growth.

Employees

The UK's current economic growth in comparison to its neighbours means that the UK job market is stronger than it has been for some time, and it has been widely reported that employers in some sectors are having difficulties filling vacancies. PWC's Family Business Survey 2014 showed that family businesses in the UK are finding recruitment a significantly bigger issue than their counterparts in other countries, with 66% of UK family businesses citing recruitment as a concern compared to 49% worldwide.

What can family businesses do to ease the pressure? It can be hard to compete on pay and indeed many family businesses accept that they cannot do so. The same Harvard Business Review article noted that: "interestingly, family businesses don't rely on financial incentives to increase retention. Instead, they focus on creating a culture of commitment and purpose, avoiding layoffs during downturns, promoting from within and investing in people."

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However, with wages on the increase elsewhere will it become harder for family businesses to attract and retain employees? Employee loyalty has traditionally been a great strength but there will always be the lure of better pay elsewhere and equally, for new employees, it will take some time to become integrated into the business and to feel the same levels of loyalty as the existing employees, so the bonds which hold them will be weaker.

Key steps that the business might consider therefore include:

- ensuring that new employees understand the benefits of working for the family business. For example there may be a number of non-pay related benefits which are highly valued by your existing staff, not least being a friendly and supportive atmosphere in the workplace and, for some, the opportunity for greater flexibility in working hours or patterns or location of work.
- review your employment contracts for key staff to ensure they contain suitable restrictions to reduce the risk of those employees being poached by competitors or setting up on their own with your client list. For example, a well drafted contract would contain a reasonable notice period, the ability to put an employee on 'garden leave' to remove them from the business and prevent them moving immediately into the next job, confidentiality provisions restricting their use of confidential business information and restrictive covenants to ensure that they are prevented from certain actions which might damage your business for a reasonable time after they leave, for example, approaching your clients.
- if you are hiring employees at a senior level, it is also important to look at the same issue from the opposite perspective, ie to be sure that you understand whether there are any restrictions in their current terms which restrict their ability to fill the role you have in mind for them. It can be expensive and frustrating to find out that a new employee cannot undertake certain functions for a number of months after their job commences because of restrictions in the agreement with their previous employer
- consider whether an incentive scheme might be useful in attracting and retaining the best employees. An incentive could be based around cash (eg bonus), equity (eg shares or options) or rewards. One advantage of an equity incentive is that it doesn't cost the company anything and it enhances employees' feeling of having a common interest in growing the business. Contrary to popular belief an equity incentive need not mean any loss of control or long term dilution of ownership so, despite a natural 'knee-jerk' reaction against giving away shares, it is well worth considering.

Management of the Business

It is sensible for any business periodically to review its management systems to ensure that they remain suitable for its current and planned operations. In other words is the business best set up for growth or could its management systems be improved?

Areas to consider include:

- Is governance of the business as effective as it might be? As the business grows, there needs to be greater structure to board-level decision-making and responsibilities. This not only reduces the risk of all of the knowledge and contacts residing with one person (with serious implications if a key person becomes sick) but also has a number of other advantages including:
  - allowing owners to delegate some day to day management responsibilities and to have time to concentrate on longer term business strategy
  - relieving owner managers from some of the stress of family-related issues. For example, if there is an agreed approach to decision making, remuneration or assessment for promotion there is less chance that family or non-family employees can feel aggrieved
  - incentivising non-family employees by giving them clarity on their role and confidence that they are being treated fairly
  - enabling delegation of key functions such as risk management and compliance, leading to better protection for the business.
- Would it help to introduce some formal board training so that board members are better aware of their roles and responsibilities, with the aim of ensuring that the board functions better?

- Would it be helpful to introduce a more formal separation between the family and the business – for example an agreement on how family issues are addressed at company level? As one respondent to the PWC survey put it "family businesses generally fail for family reasons" so it is worth paying proper attention to family issues before difficulties arise.

Reviewing the company's governance systems inevitably introduces some additional formality into decision making but can have a number of advantages, some of which are listed above. In addition it may help the overall appearance of the business to the outside world. For example, banks may base a decision on whether or not to lend partly on the basis of whether the company has the sort of governance systems which they would expect to see. Equally, if the business needs to recruit top quality senior staff or non-executive directors it will struggle to do so unless the candidates perceive that the business is well run, with clear responsibilities and delegation systems.

Innovation

Freeing some time from the daily tasks of managing the business should also allow owner-managers to consider ways to encourage innovation. This could be through training, researching new opportunities and trends within your market place or allowing time and budget to experiment with new ideas.

Long term strategy

It also helps for any family business periodically to take stock of its longer term aims and strategy. What values is the business trying to achieve, what are its business objectives and what level of funding is required to meet these? While the business may be performing comfortably at the moment, in a fast moving and increasingly global market it cannot stand still and there needs to be a 'plan' for the next steps. This could be new products, new clients, better systems or entering new markets.

Expertise

To help implement the business' strategy it is worth considering whether specific expertise is needed. If so, the business could recruit a senior manager and/or look to recruit a non-executive director. Recruiting a non-family director is often seen as unattractive because it is perceived as ceding control to a non-family member but it can bring specific value in a number of ways:

- bringing expertise on new markets, new products or raising finance
- bringing contacts and an external perspective
- bringing impartiality to issues involving family members eg selection, mentoring and promotion.

A good non-executive director can bring huge benefits to a family business but it is essential that the candidate has the right expertise and that there is a good 'cultural fit' with the business. Finding the right candidate can take time and patience so it is worth starting early.

Systems

During the downturn businesses generally minimised capital expenditure including non-essential spending on renewing business systems such as IT systems. However, if a business has not renewed its systems for a number of years this may be something to consider now. The increased efficiency that better technology can bring may make the business better placed to grow, and lack of investment may make it harder to compete with rivals.

Conclusion

Overall, as the Harvard Business Review article noted, family businesses have great natural strengths which non-family businesses would do well to replicate. The secret to success is to maintain these traditional strengths, such as loyalty, long-sighted management and personal reputation with the ability to adapt and compete in the modern market.

Changes to Company law – be prepared!

The Small Business, Enterprise and Employment Act 2015 is now in the process of being implemented. The first of its provisions came into force last month and the remaining provisions will become effective over the next six to twelve months. The Act is the product of the Government's drive over recent years to improve transparency and trust in UK companies and reduce red tape. Key changes will be as follows:

- UK companies (other than those with shares trading on a regulated market – eg the LSE Main Market or AIM) will be required to maintain, in addition to the register of members, a register of persons with significant control (known as "PSCs"). The exact definition of a PSC has not been finalised but generally speaking, an individual will be a PSC in relation to a UK company if he or she (alone or jointly with others):
  - owns or controls more than 25 per cent of the shares or voting rights; or
  - has the ability to appoint or remove a majority of the board; or
  - has the right to exercise significant influence or control over the company.

Companies will be required to provide certain information about PSCs to Companies House and this will be accessible to the public, the aim being to ensure that individuals with significant beneficial interests or other controlling rights in a company are easily identifiable.

- Subject to certain exemptions, companies will no longer be able to have a corporate director.
- Private companies will have the option to stop maintaining their own company books in relation to the registers of members, PSCs, directors, directors' residential addresses and secretaries. Instead, they can ensure that the equivalent information is filed and kept up to date on the central register at Companies House. The administrative advantage in this approach would seem to be a relatively small one but may suit some private companies.
- The annual return will be replaced with a confirmation statement to be filed at Companies House in every 12 month period (allowing a more flexible approach than the fixed reference date used for the annual return). This confirmation statement will cover similar basic information about the company as the annual return currently does (and will also include details of the company's PSCs).

For more information see our **briefing on the new Act.**

If any of the information above is of interest please contact Doug Streatfeild-James or Jim Aveline.

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Our Family Business team

Burges Salmon are unusual in being a leading commercial firm that also specialise in private client issues. We combine our business and family expertise to advise family businesses of all sizes through our specialist Family Business team - a group of experienced advisers dedicated to advising family businesses of all sizes across range of sectors.

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