How to stop family tensions undermining a shared business

In-fighting can affect a company's success

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Not all business owners make good managers. In cases of family businesses, where poor communication, personal dynamics, emotional factors, and historical family tensions can undermine business operations, the problem can become acute.

This is particularly so if litigation occurs on a divorce or a forced exit of a family member, or even on a succession to the next generation unless adequately planned for.

There are various ways to mitigate tensions associated with family operations. But three topics require special focus: adequate documentation and implementation, objective advice and exit procedures and related valuation issues.

Sound documents are needed to address future tensions and avoid unnecessary operational failures. A business road map enshrined in a shareholders agreement, company constitutional documents and employment or service agreements is vital.

Without these protections, disputes may arise (especially on a sale to a prospective buyer). Family discord may lead a buyer to put the acquisition in the "too hard" basket. Also, unless a major topic such as succession planning is provided for, the unexpected death of an important family member may threaten the business.

Such documents, once drafted and signed, should not be ignored (which is frequently the case). The settled documents must be followed or updated in practice - otherwise they may become inadequate and the expectations of some family members will not be met.

This point is borne out in one recent English case where the court was confronted with a family business under the pressure of a divorce. Some family members insisted on adhering to agreed governing documents but others did not.

The business had been struggling, and a son, by his good management, saved it. As part of the tax and corporate planning, the family company was restructured to be primarily owned by the father, mother and son.

It was intended that the couple would leave their shares to the son on death. Tax advice and carefully drafted restructuring documents said that the son did not acquire an interest in the father's shares at the time of the restructuring (as this would have created a tax liability that the restructuring was intended to avoid). Tax authorities agreed to this treatment.

But the parents then divorced. At issue was the ownership of the father's shares. Were they available for the mother to claim against as a matrimonial asset or, given that they were earmarked for the son, was his possible interest sufficient to avoid the mother's claim against the father?

The court said the father and son could not say one thing to the tax authorities and another to each other. Ownership of the father's shares remained with him.

Additional steps should also be considered. Advisory boards or family councils using non-family managers and advisers could be legislated to improve governance. Outsiders can raise points that family tensions may not otherwise permit

A limited veto right on some topics can be vested in more detached family members from the business operators. Regular meetings with clear decision-making rules will aid communication and harmony.

Succession planning and exit procedures are key topics to reflect in documents to avoid family conflict. Valuation of economic interests on an exit of an unhappy, or non-performing family member, or on a planned succession, should also be covered in detail.

The method of valuation, how a valuer is chosen, and the ability of the parties to make representations to the valuer should be spelled out in governing documents.

When no valuation takes place for many years, family members are more likely to argue about the value of shares.