

Commercial law Update

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Can a family constitution help your family business thrive?

The most successful family owned businesses plan for the future, but starting difficult conversations about the future of the business can be challenging.

These conversations may be tricky, but talking about the future is crucial for ensuring the family owned business succeeds across generations.

A family constitution can be a valuable tool to assist the owners of medium to large family businesses in discussing and implementing a plan for the future of the business.

WHAT IS A FAMILY CONSTITUTION?

As good as a family business may be, it can only succeed and endure over time if it has a solid foundation of family consensus and buy-in.

Respondents to the *KPMG and Family Business Australia Family Business Survey 2013* identified "balancing of family and business issues" as their biggest challenge, yet only 16% had a family constitution.

A family constitution is a document which records the family's values and rules for managing the relationship between the family and the business. It differs from a company's constitution in several important respects (for example it may not be legally binding, or at least not fully so). A family constitution may also be known as a family charter, code of conduct or family agreement.

IS IT ENFORCEABLE?

Usually, the strength of a family constitution stems from its status as an emotionally-binding, rather than legally-binding, document.

In contrast to legally binding documents such as trust deeds and shareholders' agreements (or, indeed, a company's constitution), a family constitution can extend to family members who are not shareholders or are not involved in the business. This can be very useful, because those in the broader family network can certainly affect, and be affected by, the family business in a number of ways (e.g. through relationships with other family members or as potential beneficiaries of or stakeholders in the business in certain circumstances).

However, it may be in the best interests of the family for some provisions to be enforceable, such as provisions regarding conflict resolution, share transfers and confidentiality. Typically, any enforceable provisions would be found in another document, usually a shareholders' agreement (it is generally best not to mix enforceable and non-enforceable provisions in the same document).

Of course, it is always important to consider how a family constitution interacts with other legally-binding documents (e.g. trust deeds, shareholders' agreements and company constitutions) and to ensure there is no conflict between the different documents.

Often, the best approach is for the family constitution to "sit above" other legally binding documents as an overarching document.

IS IT WORTH IT?

You may think a family constitution seems like a lot of effort for not much gain.

But consider what is at stake; family conflict and a lack of future planning can destroy a family owned business, but the conversations required to avoid these pitfalls are often left in the "too hard basket". This is understandable, as family dynamics can be difficult and future planning, particularly succession planning, can be a very emotional topic.

While by no means a "magic bullet", the creation of a family constitution can be a valuable means for encouraging dialogue about the future and, once created, a useful "handrail" for managing family conflict.

WHAT MIGHT IT LOOK LIKE?

One of the most important elements of a family constitution is a "mission statement" which sets out the long-term goals and strategic vision for the future of the family business.

As Stephen Covey has said, "by creating and living by a mission statement, families are gradually able to build moral authority in the family itself" (The 7 Habits of Highly Effective Families (1997)).

A written "mission statement" can be a powerful catalyst for building collective purpose and keeping the family business strong and focused.

A family constitution can also record the core values of the family. This requires deep reflection on the very essence of the family and the belief-system which everyone agrees must be upheld to protect and grow the family's wealth. Recording these values in a written document can help ensure these principles are embedded into the structure and culture of the family over time.

A family constitution can be tailored to ensure it is the right "fit" for your family; there is no "one size fits all" approach and the document should evolve and change over time.

Issues to address may include:

- » a conflict resolution procedure can be effective and has the benefit of keeping the dispute confidential (as discussed above, you may wish to ensure this procedure is legally enforceable);
- » succession planning issues (e.g. retirement ages) and a procedure for choosing individuals for appointment to management, the board and / or the family council;
- » procedures for determining how key events such as marriage, divorce, birth and death will affect ownership, participation in the business and wealth distribution;

- » procedures for employment and performance management of family members in the business (e.g. entry requirements such as experience and qualifications, remuneration and termination policies);
- » a formal mentoring program for the next generation;
- » procedures for distribution of income and wealth among family members;
- » share transfer issues such as price, transfer restrictions and terms for transfer to other family members or third parties (as discussed above, it will probably be appropriate for share transfer procedures to be legally enforceable and set out in a shareholders' agreement);
- » establish and record rules of conduct for one or more governance bodies (e.g. a "family council"), including clear decision-making processes;
- » arrangements for communication among the broader family (e.g. a "family assembly" or organised social gathering); and
- » periodic reviews of the family constitution.

HOW DO I PUT ONE IN PLACE?

Consensus is the key to a meaningful and successful family constitution and the first step is consultation to gain support from the family. It is important to decide up-front who will be involved and who will have overall responsibility for the process.

Often, a lot of the work is done at a family retreat or meeting, as a workshop environment facilitates the creative process required to develop a strategic vision. Sometimes, families choose to engage an experienced external facilitator to run the meeting and / or assist with other aspects of the development process (such as drafting the document).

While the process can be time consuming, with the right advice and buy-in from the broader family, you can develop a family constitution which the family can use to protect the family business and build wealth for generations to come.

Hunt & Hunt's Corporate and Business Advisory Group is experienced in assisting family and private businesses with a range of corporate governance and business succession issues.

We can work with you (and your other advisors as appropriate) to prepare a family constitution that's the right "fit" for your family business.

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