The Maltese Family Business: Getting Organised

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THE MALTESE FAMILY BUSINESS:
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FOREWORD

One of APS Bank's self-imposed objectives has been the dissemination of educational material to the general public and, at times, to interested stakeholders in selected areas of interest. So far, these publications focused on Agriculture, Fisheries and Environmental issues (APS Bank Seminar Proceedings Series); financial, economic, social and demographic themes (Occasional Papers Series); Maltese Culture and Identity (Music and Art publications), and Maltese Literature. In addition to these Bank's publications, the Bank financially supports publishing houses and individual authors to realise their projects.

The present publication marks the beginning of a new initiative: bringing together selected individuals who are sharing their expertise on a unifying theme. They are meant to give a wide exposure to various subjects that are thought to be of primary importance to many readers: policy makers, pressure groups and other interested individuals. These publications are

The present publication marks the beginning of a new initiative

meant to be introductory presentations in the respective area being explored. They will incorporate the latest research in the respective themes; it is then up to readers to learn more about any particular topic.

The first volume is dedicated to family businesses. Emphasis is made on both words - the family and the business, both aspects of which should both be strengthened within the Maltese society. This follows from declared political choices referring to the maximisation of human welfare, the strengthening of social cohesion and an active participatory political and economic democracy. Individuals and groups require enlightenment on the way in which their plans for life and/or work preferences can be synchronised with economic and industrial growth, inter-generational wealth and income transfers, as well as the sustainability through the competitiveness of particular industries.

We are pleased to collaborate with Mr Mario Duca who accepted to edit this first volume dedicated to family businesses. Mr Duca brought together a team of writers who share their expertise in the subject and succeed to stimulate thinking on the respective areas of interest. These essays are being offered to our readers to be both enjoyed and, at the same time, challenge them for further reflection and research.

E. P. Delia **CHAIRMAN, APS BANK**
January 2015

EDITOR AND CONTRIBUTORS

EDITOR

MARIO DUCA

With over 20 years of hands-on experience in business management and consulting, Mario is recognised as a thought-leader and pioneer in the field of family-owned business management and governance.

As a business owner, advisor and educator, Mario specialises in creating and delivering practical solutions to help families determine the right ownership structures, policies and strategies to meet their goals. He brings deep experience and specialised expertise to help families determine effective ways of instilling good leadership, enhance communication, resolve conflicts, and work together as a team. He also assists families in business with the developing of succession planning, Family and Business Governance Structures and Family Constitution.

Mario Duca MSc(Ang), Dip.Lab., MIM, is the Managing partner of Family Business Advisers Ltd, a family business, consulting and education organisation located in Malta which also provides its services internationally. He is a founding member and current President of the Malta Association of Family Enterprises (MAFE), and represents MAFE on the European Family Business Association.

Mario is an Associate Lecturer at the University of Malta. He has developed the first MQF / EQF Family Business Courses certified at Levels 4 & 5. He also delivered these courses and provided consultancy services in various countries. Mario has delivered keynote speeches and talks at a number of conferences and seminars all across Europe, covering a number of Family Business topics. He has also contributed various articles to local business magazines and newspapers, and was the author of two Family Business related manuals as part of an EU-financed project. Mario is also a part-time, lecturer at the University of Malta.

CONTRIBUTORS

DR ROBERTA FENECH

Roberta is a registered occupational psychologist with the Malta Professional Board of Psychologists. She has 14 years of experience working in Human Resources and Addictions within Caritas Malta. Over the past four years, she has been working as a freelance occupational psychologist in public administration and the private sector. Roberta is a lecturer at the St Martins Institute of Higher Education. She read for her master's degree and PhD at Birkbeck College, University of London. The title of her thesis is 'Passing the Baton: Successful Succession in Family Businesses'.

She has also been a speaker at a number of conferences and contributed numerous articles covering various Family Businesses topics.

STEPHANY GRECH DUCA

Stephany holds the post of Accountant with a leading pharmaceutical multinational company operating in Malta. Her role includes supporting the Financial Controller, VAT submissions, all capital expenditure related issues for the Malta Plant, administering Malta Enterprise Grants, bank, creditors and debtors related issues, reconciliations, auditors support, etc. Stephany is also an Associate Accountant with the family businesses where she is responsible for Book-keeping including the preparation and submission of quarterly VAT Returns and other legal requirements; liaising with external auditors; reconciliations and the preparation of full management accounts, provision of financial and accounting services for management and family business clients of the company. She also used to work within the Audit function of Deloitte (Malta).

She holds an ACCA qualification and is currently undertaking the Malta Tax Diploma with the Malta Institute of Taxation. Stephany has contributed a number of articles on Family Business issues with specific focus on accounting and finance.

KENNETH A. CAMILLERI

Following his success at the firm managing the accounting division as Senior Manager and Financial Controller for over six years, Kenneth was appointed Tax Partner in 2010. Being a Certified Public Accountant by profession, Kenneth holds a strong and versatile background rooted in the hospitality and leisure industry where he has previously held various senior positions both at administrative and operational levels.

Kenneth's expertise revolves around direct taxation and VAT planning, more specifically the structuring of high-value assets in the aviation and yachting sectors, as well as online gaming industries. He is a trusted advisor to a variety of the firm's business clients, including corporations, owner managed businesses and private individuals.

Amongst his key achievements, Kenneth has spoken at various international conferences, particularly on international tax planning. He is a regular lecturer in the fundamental and advanced papers in taxation at a leading ACCA teaching centre in Malta. Furthermore, he also serves on various taxation sub-committees and has contributed as an author on VAT in Malta to a worldwide publication.

DR PRISCILLA MIFSUD PARKER

Priscilla, who is Partner at Chetcuti Cauchi Advocates, specialises in Corporate and Trusts Law and currently heads the Corporate Department and the Trusts practice group in the firm. Priscilla mainly specialises in the use of Maltese trusts and estate planning strategies for wealth preservation and succession planning.

Priscilla assists clients in the business start-up stage or with acquisitions, corporate restructurings, shareholder matters and providing day-to-day company law and tax advice to companies, especially family businesses and individuals under the firm's administration. She also provides tailor-made tax efficient solutions to families and individuals through trusts and corporate structures set up in Malta. She is also heavily involved in executive relocation planning and related legal and tax matters.

She is a lecturer with the Academy for Law & Finance and has contributed to several fora especially on the use of Trusts in Family Businesses. She is a TEP (Trusts & Estates Practitioner) and chairs the Malta STEP Branch Technical Committee.

DR NADINE SANT

Nadine read law at the University of Malta, the University of Western Ontario, Canada and at The University of Canterbury at Kent. She has read for a Diploma of Notary Public, a Bachelor of Law, an IFSP Certificate in Trust Law and Administration, a Doctor of Laws and, after being awarded a British Council Chevening Scholarship, a Masters in Public International Law. Nadine is recognised as a European lawyer at the English Bar and is called to the Bar of England & Wales as a barrister, as a member of the Honourable Society of The Middle Temple Inn and is presently a door tenant in Chambers in London.

Nadine has worked as a legal researcher at both the University of Western Ontario, Canada and at the University of Kent at Canterbury. Nadine subsequently pursued a career as a diplomat at the Ministry of Foreign Affairs in Malta. After being called to the English bar, Nadine practised as a barrister in chambers in the Middle Temple Inn, London. After returning to Malta, Nadine joined the Attorney General's Office. Subsequently, she became a partner in a Maltese law firm and in 2013 took up the role as legal advisor to the Ministry for the Economy, Investment and Small Businesses and is Chair of the Family Business Act Committee. Nadine is also a visiting lecturer and examiner at the Faculty of Law within the University of Malta and the Faculty of Economics, Management and Accountancy.

DR JEAN-PHILIPPE CHETCUTI

Jean-Philippe is one of the founding partners of Chetcuti Cauchi Advocates, a leading Maltese law firm based in Valletta and London.

Jean-Philippe heads the firm's Private Clients practice, specialising in private client tax planning, wealth structuring and citizenship and residency planning. He is a key advisor on the Malta Citizenship by Investment Scheme, the Malta Global Residence Programme and buying property in Malta. Holding licence IIP 001, he was the first to be licensed by the Identity Malta Agency and to directly file citizenship by investment applications under the Malta Individual Investor Programme. Within his tax planning and wealth structuring function, he specialises in the use of Malta holding companies and Malta's Participation Exemption, Malta royalty companies, Malta trusts, Malta foundations and Malta Professional Investor Funds.

Jean-Philippe is the Chairman of the Maltese branch of STEP, the Society of Trust & Estate Practitioners, a member of the Malta Chamber of Advocates and sits on the executive council of the Institute of Financial Services Practitioners. He is also a co-founder and secretary of the MAFE Malta Association of Family Enterprises and has led proposals for the enactment of a world first Family Business Act in Malta.

The Maltese Family Business:
Getting Organised

PREFACE

Family businesses, which have existed for centuries now, are rooted in the intergenerational family tradition of toiling land together to earn a living. Intrinsically, families need and want to take care and look after each other. Irrespective of the business sector that the family operates in, from farming to the latest high tech fields, they exhibit the same types of concerns for each other, namely family happiness and protection because "… we are of the same blood". Throughout the ages, families always sought advice from trusted elders or other special persons whom they trusted.

Over the past decades, family businesses have come to be accepted as being different from other forms of businesses due to exhibiting some dynamics, functions, mission and objectives that differentiate them substantially from other businesses. As their uniqueness became more apparent, a new specialty began to emerge through creative, independent, well-educated and innovative individuals who have

Throughout the ages families always sought advice from trusted elders or other special persons.

become referred to as family business consultants or advisors. These look at the family business as a holistic unit while focusing on the family issues and the business not only from a specialisation area. These have replaced the trusted elders of long ago.

The Family Business sector has been gaining recognition as a major contributing economic sector within the Maltese economy. Unfortunately, there is no locally-produced book covering family business issues from the Maltese perspective. Hence, it is of satisfaction to me, having worked to promote the interests of family businesses for the past decade, that APS Bank Ltd approached me to sponsor this book. During the past years, there have also been several specialist organisations that have also started promoting family business services. In 2011, the Editor in collaboration with other family business entrepreneurs took the initiative of setting up the Malta Association of Family Enterprises, which as an NGO has been at the forefront in promoting and lobbying on behalf of family businesses. Past activities are now coming to fruition through the enactment of the Family Business Act: a first for any European country.

The contents of this book are intended to be a taster of the various issues that families in business have to face. The subjects covered are: Understanding the Family Business, Family business and change, Financial planning for Family Businesses, Governance: Having a stronger business through a stronger family, Understanding conflict in Family Businesses, Tax Implications for Family Businesses, The use of Trusts in Family Businesses, and A guide to a Family Business Constitution. All the contributors of these topics, in spite of having to discuss very complex subjects, have strived to keep them readable and understandable by all as the objective of this book is to serve as a guidebook to all involved in family businesses.

The contents of this book are intended to be a taster of the various issues that families in business have to face.

In this first book published in Malta specifically targeting family businesses, we have strived to give an overview, although not exhaustive, of the most salient issues addressing the exclusive and complex factors inherent to family businesses. It is an essential book due to the importance of family businesses in the Maltese economy and the challenges that these same families have to face especially when preparing for their transition from one generation to the next. This book is also important as it strives to highlight to non-family CEOs, managers and other specialists, the issues that families have to face and which many a time would go against standard business thinking and decision making. If such scenarios are not understood, then the advice or decisions taken in board rooms could be the major cause of conflict levels reaching breaking point which could end up destroying family unity and the business thus compounding the already complex playing field.

This book is also important as it strives to highlight to non-family CEOs, managers and other specialists, the issues that families have to face and which many a time would go against standard business thinking and decision making

The authors contributing to the making of this book are coming from different specialist fields and are contributing their knowledge and experience to the benefit of Maltese family businesses. The in-depth knowledge of the specialisation and the interactions with family businesses both locally and internationally will serve as a valuable resource for family business owners and members, CEOs and other leaders who want to have a better understanding of the dynamics at play within families in business.

An important thank you goes to APS Bank Ltd who has taken this unique initiative of financing this book, the Malta Association of Family Enterprises for the insights provided on the various facets of family businesses, every contributor and all those who have been of assistance in putting this work together.

Finally, I wish the readers every success in applying the knowledge shared in this book specifically taking into consideration the Maltese scenario and legislative framework, and I hope that through this effort we have paved the way for other publications to follow.

UNDERSTANDING FAMILY BUSINESSES

MARIO DUCA

THE FAMILY BUSINESS SYSTEM

Although there is no one common definition for a family business, the approach which is being taken by the EU is that a family business is a business of any size or form, be it a sole trader, mum-and-dad set-ups, partnerships, limited liability companies from micro to large organisations which are substantially owned and operated by two or more family members and who have control of their organisation, and listed companies who have at least 25% shareholding and at least one family member on the Board.

As a result of the dynamics at play within such structures, over and above the normal issues that other forms of business have to face such as business challenges, internal and external pressures, family businesses must also cope with the effects and impacts of the family dynamics at play both within the office and within home. As such, the advisor or more appropriately the team of advisors and the family have to be able to understand the varying influences that any family will have to manage within any family business. These relate to personal/familial issues, the interactions between the various family members and between branches of the family, how differentiated the family is, and all this over and above the technical business concerns relating to management, financial or legal matters. Ignoring this interplay of emotions, expectations, aspirations and needs, at the various levels of both the family and the business, will have an adverse effect on the business and the family.

THE SYSTEMS APPROACH TO FAMILY BUSINESS

In most cases, the issues presented will be complex and cover a number of areas pertaining to the three segments of the family system, that is Family, Ownership and Business. The Family must realise that it would require a multi-disciplinary team for the family to have a holistic solution rather than one solely based on the advisor's area of specialisation. The latter would in the vast majority of cases lead to more conflicts within the family and the business as history can demonstrate.

When working with family businesses, one must keep in mind that these are affected by a wider range of concerns and interests than one would normally find in other business forms. These concerns revolve around the relationship and interactions between the business, the family and the ownership (refer to figure 1).

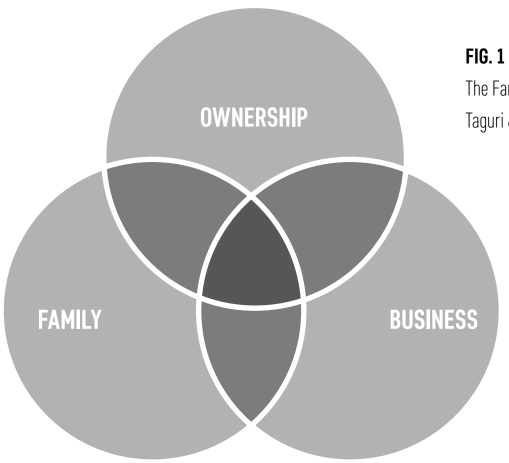

FIG. 1

The Family Business Systems
Taguri & Davies

The overlap between the three segments result in different interests, misunderstandings, mistaken assumptions and unfulfilled expectations which often leave a family firm wrapped in conflicts and disagreements. By having a sound understanding of these diverging interests, the family will be in a much better position to clearly understand what and where the conflict issues could be arising from and how they can be pre-empted. Compared to normal businesses, family businesses usually work for longer time-frames and these are influenced by the family's past legacies as well as by the legacies that the family could be building for the future.

Compared to normal businesses, family businesses usually work for longer time frames

THE OBJECTIVES AND PRIORITIES OF THE THREE SYSTEMS

Each system has its own priorities, interests and objectives and each member within the different segments will endeavour to actively protect their interests from the perspective of the segment they are in. Hence, members of the *Business Section* will have their focus on the organisation's interests with specific attention to performance, strategy, organisation structure, operational processes and other related issues. (Refer to figure 2)

Those in the *Ownership/Governance* segment will be interested in the business' legal form and the relative legislative compliance requirements, the distribution of ownership, that is, who owns what, the structure of the Board of Directors and the generation of profits for the owners to receive a fare return on their investments. The *Family System*[1] is made up of the family or families who are connected to the business. Within this segment, the family's objectives, aspirations and intentions would focus on the roles and relationships between the family members, the internal communication processes, and the interpersonal relations between the diverse family members.

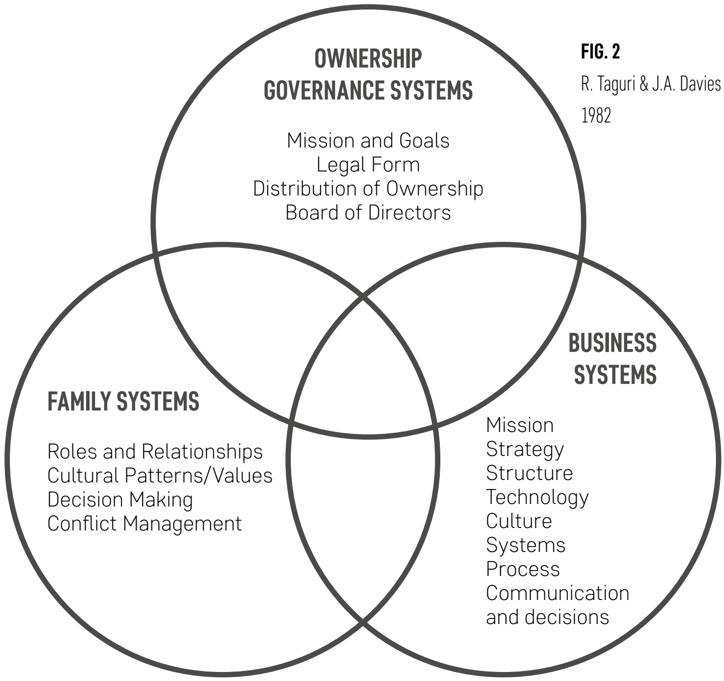

FIG. 2
R. Taguri & J.A. Davies
1982

The unique dynamics found within a family in business arise as a result of the overlapping of the three systems and the various interests that evolve due to one's position within the three circle system.

Many founders do not want to let go of the company because they are afraid the successors are not prepared, or they are afraid of ending up without a job.

Often, heirs sense this reluctance and plan an alternative career. If, however, they see a plan in place that outlines the succession process, they may be more apt to continue in the family business.

For business owners who do little planning, the idea of having to commit to the planning processes may seem overwhelming and threatening to their authoritarian position. Although it is not easy, the commitment made by all family members during the planning process is the key ingredient for business continuity and success. The first rule for successfully operating and transferring the family firm is to share information with all family members, both active and non-active ones. By doing this, you will eliminate problems that arise when decisions are made and implemented without the knowledge and counsel of all family members.

The commitment made by all family members during the planning process is the key ingredient

A STRONG FAMILY AND A STRONG BUSINESS

As can be ascertained through a number of studies conducted in Europe, it is very evident that there are two main facets having a long-term impact on family succession: a strong business and a strong family.

A major mistake mainly made by the owning business founders is that of continuing to believe that their way of managing the company is the only workable method for the business to grow and move forward. They will oppose the introduction of new technology and/or methodologies of business operations or other innovations which they do not understand thus placing them outside their comfort zone. This thinking process has a number of flaws, since no one is eternal. Therefore, they will be forgetting or ignoring the psychological and human content in the overall scenario. In the case of children, when the second, third or subsequent generations are in the process of joining the family business, they would be bringing with them new blood, ideas and most probably they are well trained thus expecting to be heard. These and other perspectives permeating from the different positions that family members hold or expect to hold in relation to the business are better grasped through an understanding of the Three Circle Family Business Systems as exposed by Taguri and Davis.

UNDERSTANDING THE FAMILY BUSINESS

As discussed, the family business is made up of three operating systems, each having an influence on the other parts in spite of the fact that many an adviser would stress that the family should be kept out of the picture. By understanding the influences and interests of the involved persons populating the various segments, one would be in a much better position to understand the dynamics at play between the particular family members, the relationship triangulations that take place and how differentiated the individual family members are. As one reviews the emotions involved, one will realise that although you and your family are unique, the challenges one faces are not, because almost every family business shares the same problems.

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Also, perspectives of the individuals involved in a family business will have to be addressed. One tends to confuse personality with perspective; understanding the viewpoints of the different actors involved in the family business (active and non-active) can thus help to alleviate conflicts that may arise.

WHAT IS A FAMILY BUSINESS?

Simply defined, a family business is any business in which a majority of the ownership or control lies within a family, and in which two or more family members are directly involved. It is also a complex, three-layer system consisting of the family, ownership and the business. Family members involved in the business are part of a task system (the business), part of the wealth system (ownership) and part of a family system. These systems overlap. This is where conflict will occur because each system has its own rules, roles and requirements. For example, the family system is an emotional one, stressing relationships and rewarding loyalty with love and with care. Entry into this system is by birth, and membership is permanent. The role one has in the family - husband/father, wife/mother, child/brother/sister – carries with it certain responsibilities and expectations. In addition, families have their own style of communicating and resolving conflicts, which they have spent years perfecting. These styles may be good for family situations but may not be the best ways to resolve business conflicts.

Conversely, the business system is unemotional and contractually-based. Entry is based on experience, expertise and potential. Membership is contingent upon performance, and performance is rewarded materially. Like the family system, roles in the business, such as president, CEO, manager, employee and stockholder/owner, carry specific responsibilities and expectations.

And like the home environment, businesses have their own communication, conflict resolution and decision-making styles.

Conflicts arise when roles assumed in one system intrude on roles in the other

Conflicts arise when roles assumed in one system intrude on roles in the other, when communication patterns used in one system are used in the other or when there are conflicts of interest between the two systems. For example, a conflict may arise between parent and child, between siblings or between a husband and wife when roles assumed in the business system carry over to the family system. The boss and employee roles a husband and wife might assume at work most likely will not be appropriate as at-home roles.

Alternatively, a role assumed in the family may not work well in the business. For instance, offsprings who are the peace makers at home may find themselves mediating management conflicts between family members whether or not they have the desire or qualifications to do so.

A special case of role carryover may occur when an individual is continually cast in a particular role. This happens primarily to children. Everyone grows up with a label: the good one, the black sheep, the smart one. While a person may outgrow a label, the family often perceives that person as still carrying the attribute. This perception may affect the way that person operates in the business.

Some families put personal concerns before business concerns instead of trying to achieve a balance between the two

Family communication patterns don't always affect the business, but when they do it can be very embarrassing. One often says things to family members in a way you would never speak to other employees or managers. This problem is compounded when your communication is misread by the family member. Parents are often surprised by a son's or daughter's negative reaction to a business directive or performance evaluation. This reaction is probably due to the individual's perceived instructions or evaluation as orders or criticism from Dad or Mum, not from the boss.

System overlap is apparent when conflicts of interest arise between the family and the business. Instead of trying to achieve a balance between personal and business concerns, some families end up giving priority to one at the expense of ignoring the other. It is important to understand that the family's strong emotional attachments and overriding sense of loyalty to each other create unique management situations. For example, solving a family problem such as giving an unemployable or incompetent relative a position in the firm ignores the company's personnel needs but meets the needs of family loyalty.

Another example of conflict of interest occurs when business owners feel that giving children equal salaries is fair. Siblings who have more responsibility but receive the same pay as those with less responsibility usually resent it. In cases of sibling rivalry, it isn't unusual for one sibling to withhold information from another or try to engage in power plays, i.e., behaviours that can be detrimental to the firm.

Much of this behaviour can be eliminated or managed by devising policies that meet the needs of both the family and the business. Developing these policies is part of the strategic family planning process. Before discussing them, you should make sure one has identified all the issues that need to be addressed.

CONCLUSION

The objectives, ideals, values and sense of purpose developed by the family through family meetings are a vast resource for the family business. Concurrently, owning a family business provides an unmatched opportunity for the business family to grow and develop within society.

Through the establishment of family meetings, the business owner is able to make the most of the human and other resources within the family. In fact, family meetings are one of the two most important processes in ensuring family business continuity, the other process being that of appointing independent directors on the family business board.

Also through the holding of structured family meetings, family relations are developed on a stronger footing and thus a stronger business evolves. Other benefits include those related to future planning of the family business, the planning of who can be involved in the family business and opening up the succession process. In this way, the longevity of the family business life will be continuously extended by each generation in accordance to the changing business and economic changes that would be taking place.

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THE STRUCTURING OF GOVERNANCE IN THE FAMILY AND THE BUSINESS

MARIO DUCA

A number of international studies demonstrate that developing a strong business and having a well-organised family have a longterm impact in achieving successful transitions between generations. A major mistake that many a time founding business owners do is that of continuing to believe that their way of managing the company is the only workable solution for the business to grow. Thus, they will oppose new ideas, new systems, the introduction of new technology and/or methodologies of business operations whilst at the same time being more averse to taking business risks. This thinking process has a number of flaws. No one is eternal and in the case where children are interested in joining the family business, they have to be encouraged to join and contribute towards the family business. Family elders who keep excluding the next generation from taking over the management and control of the business and do not realise the need to develop structured governance processes both for the family and the business will be actually reneging

> **Developing a strong business and having a well organised family have a long term impact**

or ignoring the psychological and human realities in the overall scenario. When the second, third or subsequent generations are in the process of joining the family business,they would be bringing new energy, new ideas, a new competitive attitude and most probably they are better educated thus expecting to be heard. All these new dynamics cannot be left on their own. They have to be organised, otherwise conflict will be the end result.

But what about the rest of the family members who might have expectations and aspirations arising out of the fact that they are also members of the same family?

BUSINESS PERSPECTIVE ADVICE

Various consulting specialists emphasise that clear objectives for an independent and fully functional Board of Directors are critical to the survival of the business through the generations but at the exclusion of the family. The trust in governance is clearly on everyone's mind especially from a business perspective. At the same time, governance can mean different things to different family businesses. To this end, agreements such as Shareholder, Employment and Remuneration agreements are set with the objective of having some form of order within the business. The main objective here is to regulate the family member shareholders and establish some semblance of understanding of how they are expected to regulate their relationship as shareholders within the business. But what about the rest of the family members who might have expectations and aspirations arising out of the fact that they are also members of the same family and who at one point or another can become shareholders or start working in the business?

As a result, strategies that look to optimise the different forms of the wealth of families in business would need to include specialist advice on the proper governance not only of the business but, even more so, that of the family. In fact, the family cannot be left out of the equation that is the family business because if not approached, the family will at one point or another rebound onto the business with a vengeance. Irrespective of the fact that the family business is micro, small or a large enterprise there exist a mix of family dynamics, business strategies and ownership decisions particular to that family in business that can be the root cause of different emotionally-charged dynamics within the family business. This would in turn directly impact the decision-making processes that are put in place within the business itself. To complicate matters, a multi-generational family business with a diverse mix of owners' involvement and interests in the business will raise the tensions between the relatives from different branches which will cause trust to decline hence leading to increased possibilities of destructive conflict.

FAMILY GOVERNANCE

At this point, how can family business ownership tap into the potential resource of the family as the locomotive to push forward the family business? At the same time, how can the current owners attain the best conditions for the business as an opportunity for business growth, increase its current potential and showcase its values and goals to society?

Under these circumstances and through research, it results that there are three main issues that have a direct effect on the longevity of a family business. These are frequent structured family meetings, developing of ongoing strategic business planning processes and having effective boards of directors. Providing governance structures for the three systems found within the family business, that is the Family, Business and Ownership will increase the chances for successful transitions over generations.

An important move by the family business is to advance towards the idea of setting up and holding regular and structured family meetings. These periodic meetings bring the family together to share goals, decisions, discuss

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Introducing innovative management techniques in the business and operating in a more democratic system as opposed to the more rigid control system, will enhance acceptance by the family with reduced conflict scenarios.

common problems, learn about the business, and to preserve family identity, values and traditions. Thus, family meetings can help in building a stronger family and subsequently a stronger business. Through these family meetings, the family plan for the future of the business and difficult issues can start to be discussed in a constructive manner. Through these meetings, the family members manage to smooth out such issues such as that of succession of the present leadership and how it should be managed, or that of making the business operate in a more professional, structured and organised process. Introducing innovative management techniques in the business and operating in a more democratic system as opposed to the more rigid control system, will enhance acceptance by the family with reduced conflict scenarios. Furthermore, through the open discussions they can avert painful and costly conflicts by assisting the family to address those issues that inevitably arise in any family business ownership, such as remuneration of family members, distribution of dividends and the amounts to be distributed, employment of offsprings and other relatives, entry of spouses into the business, exit strategies, etc.

Factors other than holding of structured family meetings relate to another two areas that must be considered so as to ensure that the continuity of the family business is safeguarded. These are that of establishing an active Board of Directors and the other being for the business leadership to engage in an ongoing strategic planning process involving both the business and the family. Unfortunately, as a result of the above-mentioned action processes not being implemented, from various studies it results that 70% of all family owned businesses fail during the succession phase from first to second generation.

There are a number of significant goals and benefits that can be achieved through the holding of family meetings. Some of the most important ones are:

» Developing stronger family bonding
» As a result of the above, a stronger and longer lasting family business
» Organising and managing the family participation in the family business
» Considerably reducing bad feelings and opposition from spouses and family members not directly involved in the business
» Embarking on a structured succession plan and the future ownership of the business
» Educating children to manage inherited wealth
» Effectively developing and managing the relationship between family and Board of Directors

FAMILY BUSINESS DISCUSSIONS

With small family businesses, the discussions would normally occur spontaneously and during the early growth phase around the dinner table, at weekends or during a family gathering. But once the family and the business start growing, these processes have to become more formalised and structured. Hence, the governance process must encompass both the family and the business.

While a strong Board of Directors will be necessary to manage a complex family business and the family shareholders will have fora in which to voice their distinctive interests and concerns, these are not sufficient. Cooperation and trust within the enterprise will depend upon the support of all family members. This support will come not only from those directly involved in the business as shareholders and shareholders who are working in the business, but it must also come from family members working in the business and other relatives who will be aspiring that at some point in time they will also be part of the ownership of the family business.

Hence, governance focuses not only on the development of structured and active Boards, but an integral part of it is also dedicated to the development of family governance through the setting up of the Family Assembly and/or Family Council. The objective is to help families in business understand the fundamental purposes of these different forms of Governance as each family has to be helped to customise the different structures to fit its specific needs. There exists no set template that can be used across the board to suit all families. Hence each family has to be assisted in developing the governance structure that best fits with its wishes and way of doing things, the way they want to do things. At the same time, the vision and mission of both business and family have to complement each other and not compete with one another.

There exists no set template that can be used across the board to suite all families.

Any family business is composed of three integral overlapping systems which are the Family, Ownership and Business. Each of these three subsystems continuously influences the direction, relations and operations of the family enterprise as well as the family. Thus the importance of having a holistic approach towards governance, where each system has a clear and defined role and a place in which its voice in governance of the overall structure is heard.

Boards of family enterprises usually change over generations as the family business moves from controlling owner to sibling partnership to cousin consortium. During these stages, the board is composed, in its majority, of family members. However one thing that is definitive is that with the growth of the family and the business the governance complexity increases. Therefore, doing nothing is not an option available to the family. This can be more pronounced when the family has arrived at the cousin consortium stage where one could find two or more cousins controlling the company, having an over population of family board members with highly politicised boards.

Through the setting up of family and business governance structures, we will be providing for the clear separation and the balancing of powers of the different family interests which are a direct result of the family dynamics taking place. For example, the Board or the shareholders, the family or the family assembly directly have the right to set the direction of the business. On the other hand, it will be the family assembly that would be setting the policies for the family as ratified by the family assembly. At the same, time we have to make sure that the assembly and the board have clearly defined roles and responsibilities such as clearly establishing the reserved matters that are the responsibility of the family and reserving these decisions for the board.

MISCONCEPTIONS AND FEARS

Many founding family business owners think that setting in motion the idea of family meetings will deprive them of the authority and independence they have in the business. This fear of the unknown is unwarranted as while family meetings provide a forum and opportunity for the family members to voice their opinions, this in no way would mean that the family members are wrestling any power from the managing member. Establishing family councils and meetings does not mean that anyone is taking away the responsibility and independence of management, experience and ownership from the managing owner. On the contrary, they could be a source of new ideas for the managing owner and could also act as a safety valve in case hot issues crop up. Through these meetings, the managing owner would get to better understand the various questions that could be nagging the other family members.

> Family meetings... could be a source of new ideas for the managing owner and could also act as a safety valve in case hot issues crop up

Some unconscious barriers that family business meetings could raise relate to when the founder's retirement or the issue of a new generation entering the business or into ownership start being discussed. For the family business managing parent, this could mean that the person has to start facing the fact that s/he is a mortal and therefore must someday let go of the business control even though the person might still feel that s/he has a lot to give to the family business. For a business owner who cherishes independence, privacy and secrecy, sharing even of a small dose of information about the family business is very heart wrenching. But these are actions that have to be taken for the benefit of the family and the business.

The family members could start to appreciate more the difficulties that the business goes through and the market competition that exists

WHAT IS THE RIGHT TIME TO START INVOLVING THE FAMILY?

It is never too early as the earlier the structure of family meetings is implemented and procedures are set in place, the more one minimises the risks associated with disgruntlement and opposition from family members to the business. The earlier these are stated, the more family members, especially young children, will be able to understand the reasons behind the long hours that the father is spending away from home. Thus, the family members could start to appreciate more the difficulties that the business goes through and the market competition that exists.

Hence, the earlier family councils and meetings are established, the earlier the next generation and the other family members would start to appreciate the needs of the business and the contribution the family can do for it.

CONCLUSION

The objectives, ideals, values and sense of purpose developed by the family through family meetings are a vast resource for the family business. Concurrently, owning a family business provides an unmatched opportunity for the business family to grow and develop within society.

Through the establishment of family meetings, the business owner is enabled to make the most of the human and other resources within the family. In fact, family meetings are one of the two most important processes ensuring family business continuity, the other process being that of installing independent directors on the Family Business board.

Only through such structured approaches can any family in business aspire to be able to transcend the generational transitional challenge. The path is not easy. The greatest challenge of any family business owner is how well s/he has managed to educate and organise the family to work together in being fit and proper managers and owners of the wealth that they will be receiving.

FAMILY BUSINESSES AND CHANGE

MARIO DUCA

As anything else in life, change is a given fact but in spite of this, even the mention of change often can instil discomfort due to the the insecurity that comes along with it. Despite being aware that some things must change because of the changing nature of the environment we live in, such as when the next generation family members start joining the business or when the time comes to start planning for succession, most would hesitate to take action. It is essentially easier to continue to operate and invest in the old tried and tested traditions that everyone feels comfortable in rather than venturing into the new and unknown.

> Shifting the work environment and responsibilities can cause anxiety

CHANGE AND TENSION

Within every change initiative, shifting the work environment and responsibilities can cause anxiety particularly when family members leap into unknown territory. The challenge is even greater when there are varying views amongst family members on the change initiatives being undertaken and when the change process is initiated too late in the family business cycle. The thought of not knowing whether one will be able to perform within the new expected framework automatically increases anxiety levels and frustrations in people. Many families in business are fearful of any change initiative or restructuring that might cause conflict amongst family members, make uneasy other senior members of the firm or be the start of the demise of the enterprise. For these reasons, many avoid change for as long as possible, and when it is no longer possible to look past it, many simply try to patch up by engaging in minor alterations that do nothing for the long-term sustenance and survival of the family enterprise. However, when approached with strategic, well-thought out and designed objectives in mind, change is not a negative score at all. On the contrary, when successful, change often results in the commencement of a new era for the family enterprise, increase in growth, stability and success.

ORGANISING THE FAMILY AND THE BUSINESS

Keeping a business in the family isn't for the faint-hearted, as many can confirm. But while only a third of family-owned businesses succeed under a second generation of ownership, with the survival rate dropping to about 10 percent when the third generation takes over, it remains true that 40 percent of Fortune 500 businesses are family-owned. One must start early if one dreams of passing his/her legacy on to the next generation.

> It remains true that 40 percent of Fortune 500 businesses are family-owned

With the passage of time and as the business and the families within that business grow, it becomes imperative to formalise and structure the relationships, roles and responsibilities as well as involvement of the family with that of the business. The family must agree to abide by an agreed way of doing things if they want to participate in the business. This is achieved through the formulation of Family and Business rules that essentially are written agreements entered into by the family members participating in a family-run business.

The vast majority of family businesses have, as part of their objectives, the passing on of their legacy to future generations. This immediately raises the concern that what is good and viable for the current generation and the way that things are done at present will not apply in the same way for the next generation.

This is because, amongst others, business conditions and market climates change, family members' expectations change, commitments and aspirations change. Thus, families who seek continuity of their ownership and management of the family business through the generations are encouraged to consistently innovate and embrace change for the benefit of their legacy in business. For many family businesses, success is measured by the number of generations that have managed to retain the business within the family. For longevity to occur, the business and the family have to develop their abilities to innovate, become better organised and be able to embark on diversification processes. They also have to develop other skills that will enable the enterprise and the family to adapt so as to thrive from generation to generation. No generation is the same, hence change is a continuum of life which unfortunately goes against the family norm where change is avoided as it is perceived to create instability and could cause conflict within the family. Whilst the business is growing so will the family. Concurrently, the business will be under continuous pressure to accept and include new family members; embrace an increase in the number of generations involved in the business and adapt to a widening age difference even within the same generation. As such, the family and the business' ability to adopt to change are good indications of the success possibilities that the family will have in passing the business through the generations.

For many family businesses, success is measured by the number of generations that have managed to retain the business within the family

TRIGGERS FOR CHANGE

As family business consultants, we often encounter family members who ask us why should their family enterprise envelop change when they are a successful business run by a united and understanding family? The fact is that when things are going well, there is very little will to consider going into any form of change process. This is even true when everyone is aware that change has to take place for reasons such as the notion that the current leader cannot steer the ship forever. Mortality makes change inevitable. Most commonly, for family firms to embark on a change process there has to be a trigger that would force the family to act. Unfortunately, this trigger often originates through some form of pain such as a reduction in market share or profits, a disruption in family relationships, a family member suddenly taken ill or next generation family members entering the business. When such triggers fail to prompt the family business into action, the pain and effort required to implement the inevitable will escalate to a point that very few options would remain for that family. At the same time, if family relations are allowed to go stale these will often result in cut-off and there will be very little that could be done to salvage and rebuild the family bonds.

Most commonly, for family firms to embark on a change process there has to be a trigger that would force the family to act

Going through change as a family group can create a feel good factor and re-enforce the group's self-belief but more often than not, family groups develop solidarity against change due to the fear of the unknown. Family members and potentially employees have occasionally joined forces to prevent important change from being implemented. Examples of this can be observed when the business has grown to a level that introducing non executive directors would greatly benefit the firm. In such instances, family members can be wary and strongly opposed to such an initiative. Resistance occurs as this will be perceived by those members who will have to relinquish their position as a threat to their status. To make matters worse, as there will be other family members who would remain on the board, jealousy will raise its head with the risk of increased conflict. To further complicate matters, different people have different levels of tolerance to change. Those who accept change as a natural process would be impatient and believe that the family or the business are stagnating if the process is slow. Those who resist change feel overtaken by all the pressure around them.

Those who accept change as a natural process would be impatient and believe that the family or the business are stagnating if the process is slow

In any group, there will always be those who embrace change and those who oppose it. However, one needs to keep in mind that most of us were not built for the pace of change that we are having to face in this day and age. As such, the following proposals are being put forward:

- Implement change in an evolutionary rather than a revolutionary approach;
- The family has to respect the past whilst at the same time adopt new ideas and look at the future;
- Recognise change for what it is and reassure the family and the company that what follows will be an organised change process;
- Do not embark on change for the sake of change, as change on its own is not a guarantee for improvement; and
- Explore all options possible before embarking on a change process and do not jump to the first solution that presents itself.

ORGANISING THE FAMILY AND THE BUSINESS

The purpose of the Family Business Constitution is to establish a code of conduct and operating procedures that would regulate certain aspects of the business. It will also define the role that each member of the family will play in the development of the family business and its progression from one generation to the next thus being referred to during difficult change phases.

For a family constitution to be successful, it must be custom developed so as to suit the particular family business

The family business constitution is a road map that, when completed, will strike a balance between, on the one hand, the rights, obligations and expectations of the family members and, on the other hand, the commercial and financial needs and requirements of the family business.

For a family constitution to be successful, it must be custom developed so as to suit the particular family business. It must evolve with time as the business and the families within grow and develop, thus taking in stride the changes that the family and business are going through. Furthermore, the depth of detail that the family constitution goes into depends on the objectives the members of the business have set out for themselves.

A Family Constitution is an area of business which is not regulated by any law. It is the result of the family members' relationship between themselves and with their business. This can be modelled according to their needs as they arise over the years.

The ultimate objective of a business family constitution is to increase the chances of survival of the business during its different phases through succession procedures over several generations. Hence the main purposes of a business family constitution are:

» To ensure a harmonious collaboration between the members of the family business as well as within the family
» To clearly establish a fair process of the distribution of the profits generated by the business among the various family members
» To strengthen the relationships between the family members
» To guarantee the independence and prosperity of the family business

FAMILY CONSTITUTION OR CHARTER

A Family Constitution or Charter is a communication and decision-making tool that sets out the values that are important to the family. It also sets out the rules for resolving problems in a united and peaceful way. The structure of a family charter is developed as a memorandum of understanding which acts as a reference point that clearly sets out the criteria for the goals, management, philosophy, share ownership, working relationships, family relationships, and succession of the family business. In addition, a family constitution is normally developed as a more formal and fully-fledged legal document binding all family members who are signatories of the document.

> The key to avoiding serious conflict is to involve family members in the process of creating the family charter or constitution

The key to avoiding serious conflict is to involve family members in the process of creating the family charter or constitution. Set aside the time to discuss the components and get consensus. Refer to the document regularly to clarify direction and resolve conflict.

The family charter or constitution should be construed as a living piece of work. As such, this has to be refreshed every couple of years so that it could reflect the changing needs of the family and the business thus making adjustments to reflect any important internal and external changes.

SALIENT SECTIONS WITHIN A FAMILY CONSTITUTION

Family business constitutions are made up of three main sections:

a. The first part recounts the family history and how the business had evolved during the years. It clearly sets the family values for which they stand.
b. The second section defines the rules of governance of the family unit within the ambit of the family business. It clearly establishes the different categories of players within the family business.

It also attempts to address the expectations and ambitions of the different players.

c. In the third section, it strives to establish the framework of the various committees (such as family assembly and/or family council) so as to ensure a free flow of communication. Secondly to establish the way in which conflicts are managed within the family business by setting up procedures so as to reduce tension.

This process, however, is not straightforward. It requires high levels of commitment, a willingness to listen and talk to one another frankly, to grapple with taboos and for all to be prepared for some discomfort, sometimes even pain.

FAMILY COMMUNICATION STRUCTURES

Ensuring that the family can communicate is vital to a healthy business. To this end, it is important to create structures that will improve communication within the family.

Owners are generally hesitant to construct these communication structures because they are afraid of having to deal with any conflict

Owners are generally hesitant to construct these communication structures because they are afraid of having to deal with any conflict, either within the family or within the business. They also fear losing control of the business as the accountants and lawyers transfer assets to the next generation. They are concerned that their wealth will be eroded.

FAMILY ASSEMBLY AND/OR COUNCIL.

The purpose of a Family Assembly and/or Council is to create structures for the business and family issues to be discussed in regular and structured meetings. The structures and membership will vary from one family to the next.

Creating the structure/s is important because it allows a place for people to talk and let off steam. The Family Assembly and/or Council sets out the important principles that initially come from the founders of the business. This is their family leadership role. The rules around how the Family Council works and the actual holding of the meetings are ways to engage direct family members as well as spouses and children.

AN OUTSIDE ADVISORY BOARD

Involving a non-regulatory body can include other entrepreneurs, professional advisors, trusted friends and other non-family members.

The role of the advisory board is to mentor and direct the family business in such areas as planning and decision-making. Research has shown that advisory board members bring additional perspectives to the table and can greatly improve the quality of the decisions made.

Board members bring additional perspectives to the table and can greatly improve the quality of the decisions made

FAMILY PARTICIPATION POLICY

Involvement of family members in the business is an outcome being taken for granted but the number of those who could be involved depends on the size of the business and the life aspirations of the family members. Therefore, having a family participation and employment policy is an important tool that should be part of the constitution.

This policy sets out the criteria around whether family members and/or their spouses are welcome in the business and what they need to do to participate in the business. It also relieves some anxiety that family members will not be disowned from the family if they don't participate in the business.

FAMILY BUSINESS ANNUAL SHAREHOLDERS' MEETING

This annual activity should not only be a formal business event but should also act as a program focused on celebration and education. It is a step-by-step process to bring family members into an ownership role and frame of mind within the company while allowing the entrepreneur to continue his/her leadership of the business.

The annual shareholders' meeting should be a tool that helps improve the communication between family members. In addition to being a time of fun and celebration, it is an opportunity to state and clarify the facts of the business. Typically, family members appreciate this event and are further energised about being in business together.

Effective change is part of the platform that fosters continuity through the generations

CONCLUSION

Change for the sake of change consumes a lot of energy with little or no benefits. On the other hand, effective change is part of the platform that fosters continuity through the generations. At the same time, reaching consensus takes time, but this is an essential part of the process. Indeed, many family businesses have found the process is on-going. As the family and the business continue to evolve, so does the Family Constitution - it becomes a living document. Families in business are very adaptable, comfortable with showing care and attention and able to resolve most conflicts which change brings their way knowing that "whatever happens to this family, we can solve it out". Having a tool such as a Family Constitution can replace much of the uncertainty of the future with the certainty of a fair and equitable structure created in advance of any conflict arising.

UNDERSTANDING CONFLICT IN FAMILY BUSINESSES

DR ROBERTA FENECH

INTRODUCTION

When real or perceived differences give rise to negative emotions, conflict may arise. In a family business, these differences may be present between generations, within the same generation in the same family unit, or between family units. Conflict is inevitable particularly as families expand and grow. It may underlie a variety of issues related to the family business such as succession, management and inheritance. The very overlap between the family, business, and ownership sub-systems may be a cause of conflict. The objectives of this article are to understand the role conflict plays in family businesses; relate conflict to issues of justice; understand the processes that may lie beneath sibling rivalry at a latent level; address conflict management; using conflict for positive outcomes.

Conflict is inevitable particularly as families expand and grow

Many times, family members find themselves fighting about underlying issues as opposed to core ones. Management problems may be particularly difficult to resolve because left over emotions from family relationships can interfere with business decisions. There are proponents of the argument that conflict serves a dysfunctional and destructive role in family businesses. However, the role conflict plays is described differently by proponents who believe that when managed positively, conflict may result in innovation, creativity, change, greater efficiency, and growth for both the business and family members. In this article, both perceptives on conflict are addressed from the point of view of management of the dysfunctional aspects of conflict as well as ways to harness it in the pursuit of positive outcome.

When managed positively, conflict may result in innovation, creativity, change, greater efficiency, and growth for both the business and family members

JUSTICE

The sources of conflict in family businesses vary from individual personality differences, communication problems, power imbalances to unresolved issues from the past and interpersonal factors. Amongst the interpersonal factors are issues related to fairness within the family and business sub-systems that influence the business as a whole. Family members take for granted things to be fair and therefore expect a balance of investments and entitlements in relationships across the ownership, management, and family sub-systems, of the family business. In a family business setting, conflict and lack of trust can develop because the next generation perceive an imbalance between contribution and credit, feelings of inequity, and an absence of fair play. Such a lack of trust influences the business climate, affecting job satisfaction, motivation, and performance.

Trust within family relationships is governed by principles of fairness and justice. There exist distributive and procedural justice. Both the distributive (perceived fairness of the manner in which rewards are distributed) and procedural dimensions (perceived fairness of the procedures used in making decisions) of justice are important, however family members emphasise more the importance of procedural than distributive justice. Procedural justice entails a degree of fairness of the process applied to resolving contradictory claims from various stakeholders.

Fair and just decision - making in family businesses is aimed at (however not necessarily attained):

- » Giving those concerned a voice and ensuring views are heard and represented (Communication and Voice);
- » Giving clarification that leads to shared goals and clarification of potential areas of conflict (Clarification);
- » Consistency between intent and actions (Consistency);
- » Altering decisions to reflect new knowledge (Changeability).

Avoiding conflict deprives the family of learning ways to deal with it

CONFLICT MANAGEMENT

Although the deferral of the conflicting situation may work in the short-term, the sources of conflict do not go away with a simple avoidance. Avoiding conflict deprives the family of learning ways on how to deal with it. Conflict management in family business entails primarily addressing the emotional component of such conflict. Anxiety related to succession may be the underlying cause of conflict or the feelings of inadequacy experienced by the next generation in new situations. Awareness of one's feelings and those of others by listening and empathising with others is always a good place to start off at.

Family norms for resolving conflict in family businesses also tend to be the same norms utilised in the business. The most important issue is how effectively and co-operatively conflict is managed. There are at least three strategies a family can use to deal with conflict: arbitration, compromise, and creative resolution.

Arbitration: Family members often seek an "arbitrator," a third party, to help resolve disputes. Sometimes "Mum" is a great ear. She usually listens sympathetically and may have special influence over other family members. Other times, a key business adviser or non-family executive is approached by a family member: "I think such and such. Can you help me convince my relatives about that?" Sometimes an arbitrator or mediator can help not by proposing a solution but by serving as a forum that elevates the quality of the debate. A board of directors, especially one that includes independent directors, can provide that forum. The effective arbitrator avoids taking sides and responsibility for the solution. He/she returns responsibility for resolving a dispute to those directly involved.

Sometimes an arbitrator or mediator can help not by proposing a solution but by serving as a forum that elevates the quality of the debate.

Compromise: This entails the direct discussion of conflicts. Sometimes it can produce workable compromise.

Creative Resolution: What do you do when compromise is not possible? Most important issues can benefit from the extra effort of seeking new, creative alternatives. A buy-sell agreement might be funded over a longer time if the seller is comforted by the security of knowing that if the business is sold, he or she can still benefit from any increased value of the company at the time of the sale. The aim is to achieve win-win synergistic resolutions.

Any of the three above may work for a family business depending on a number of circumstances, starting off with the nature of the problem addressed. Family businesses tend to have a history in solving issues in a particular mode or interpersonal characteristics that incline them more towards one form of addressing conflict than another. Resolving conflicts in a family business requires patience and skill. A few useful steps are:

» Defining the problem first; don't start by presenting a solution.

» Proving you understand the other person's concerns by restating them and asking if that understanding is correct.
» Putting all your energy into debating the issue. Don't allow yourself to get personal.
» If resolution comes slowly, brainstorming more alternatives. Ask others to propose new alternatives without initially evaluating any of them.
» If the going gets tough, taking a break. Come back to the topic the next day. In the meantime, resist dumping it on anyone else.
» Remember that how you address a problem will be long remembered. Think about what you say and how you say it.

WHAT LIES BENEATH SIBLING RIVALRY

There is more to conflict in family businesses than meets the eye. Emotional and unconscious dynamics shape what happens in the family business. To utilise an iceberg analogy, there exists a large mass that lies beneath the observable surface influenced by unconscious processes. Sibling rivalry is a common theme in accounts about siblings across all literature. Retired, current, and next generation family business leaders are all concerned with this potential threat within their family business. The desire of the current generation prior to thier retirement is that their children share leadership of the family business and remain united both in business and within the family. The threat of sibling rivalry spurs the current generations to take charge and try to establish clear roles and boundaries within the family business whilst they are still actively involved. There are also current generation family business leaders who keep delaying retirement as a result of this fear.

Sibling rivalry is a common theme in accounts about siblings across all literature

Power struggles may be the underlying reason for sibling rivalry. Power frequently evokes competition and competition may give rise to stagnation when unresolved, therefore preventing the giving and taking of authority. Siblings may as a result choose to exclude themselves or are excluded from the family business. The next generation in turn have their own fears for subsequent generations when they look into the future. The increase in family size as the sibling partnerships develop into cousin collaboration is a source of anxiety for the next generation. They are also concerned about the jealousy that may infiltrate into the family dynamics at that point in time.

In the family system, siblings are equal by birth-right unlike in the business system where they do not all have the same roles and some may have more power than others

Power struggles may also be understood as a regression to childhood experiences where sibling relationships are marked by equality. In the family system, siblings are equal by birth-right unlike in the business system where they do not all have the same roles and some may have more power than others. This innate contradiction within the family business may be a reason for the underlying power struggles. Authority situations within the family business are likely to stir anxiety and conflict as family members try to recreate situations that are analogous to their infancy, consequently reactivating characteristic problem solving methods used at the time.

Another struggle is that related to the perceived 'intrusion' by in-laws. This mode of thinking reflects a polarisation whereby the perceptions of the family members are seen as right and that of outsiders as wrong. In-laws are many a time used as a means to escape from the uncomfortable thoughts and feelings on sibling rivalry. Blame for such thoughts is placed on 'outsiders' so no authority is taken for such feelings and no responsibility is accepted for failure in relationships within the family business.

Harvey-Jones (1990) writes about the personalisation of failure and the tendency to find guilty scapegoats as a way of reducing anxiety provoking situations into manageable chunks. The views on the in-laws in family businesses may be reflecting such tendencies. Klein (1959, 1975) writes about the psychological splitting of self and others into good or bad and the defence mechanism of projecting onto others our bad 'introjects'. This may better help explain the way in-laws are perceived with fear and within a negative light by family business members. Klein (1959, 1975) adds that splitting is the failure in a person's thinking to bring together both positive and negative qualities of the self and others into a cohesive and realistic whole. The family members may be unable to understand that in-laws are whole individuals who are capable of both good and bad because of the anxiety provoked by the succession process.

In-laws are viewed as the black sheep and the family as knights in shining armour, reflecting primitive feelings of love and hate. The exclusion of in-laws is an aggressive gesture adopted in handling the anxiety caused by a perceived threat. Stapley (1996, 2006) writes that the defence mechanisms of splitting and projection are "some of the most important defence mechanisms, and they are frequently found in use in all manners of human settings" (p. 58). The incumbents' and next generation's fears of sibling rivalry and power struggles result in the projection of unacceptable behaviour onto the in-laws. Projection occurs unconsciously and automatically as a defence mechanism to cope with the anxiety generated by the thoughts of sibling rivalry and power struggles.

Projection occurs unconsciously and automatically as a defence mechanism to cope with the anxiety generated by the thoughts of sibling rivalry and power struggles

USING CONFLICT POSITIVELY

Effective management of conflict channels the natural energy of a family business for constructive change. The stimulation of conflict through the presentation of conflicting views may be a way family business members are trained to address conflicting perspectives. Co-operative learning also helps family members deal with conflict in a constructive manner.

Family members can harness the positive effects of task conflict by encouraging mild expressions of it and proactively preventing its intense expressions. One way to do this involves the way in which conflict is framed. Conflict is often considered to be a bad element in business, but family members can focus on the informational benefits and positive affective outcomes of mild task conflict. Furthermore, if family members acquire information from conflicts, positive active emotions and resultant job satisfaction can ensue. It is important that family members distinguish between intense and mild task conflict expressions because they may have opposite effects on family relations.

Family members should foster debates and expressions of differing viewpoints in an active learning context

While it may seem intuitive that family members should encourage mild task conflict expressions such as debate and expressions of differing viewpoints, there exist specific contexts where it is particularly beneficial to do so. Family members should foster debates and expressions of differing viewpoints in an active learning context where information acquired through mild task conflict will be appraised positively and capitalised upon, thus energising each other. Debates should also be encouraged in situations of cross-functional work; mild task conflict expressions between family members who have different job functions produce useful and novel information and thus energise family members.

CONCLUSION

Conflict in family businesses is always intricate as it influences the family, business, ownership, and management sub-systems. It may only be understood as a multi-faceted and emotionally-laden natural happening. Resolution does not only entail addressing the rational and apparent processes but also the more hidden and often unconscious processes that make resolution a process that is best approached with a reflective mindset.

Professionals working with family members in addressing conflict act as containers of the fears and anxieties that are experienced by family members. Such professionals are alert to more covert dynamics and address the emotional task of the organisation which is many a time filled with difficult experiences such as competition, rivalry, jealousy, envy, and hostility. The professional is a temporary holding environment for the family members to interrelate with until they have reintegrated their new culture.

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FINANCIAL PLANNING IN FAMILY BUSINESSES

STEPHANY GRECH DUCA

Every time one thinks of a family-owned business, one's mind goes straight to the scene in *The Godfather* where Michael Corleone says, «It's not personal son, it's strictly business". This is a fictitious stereotype of family business – dysfunctional and dangerous. However, in reality, there are a lot of successful family businesses responsible for creating wealth, jobs and the advancement of many industrial sectors. Family businesses are often an overlooked form of ownership, yet they are all around us – ranging from the neighbourhood corner food store to the thousands of small and medium-sized companies that underpin many economies, to household names such as Ford Motors, Wal-Mart Stores, Carlson (travel and hotels), Marriott International and others. It is estimated that about 70 to 80% of all business enterprises in Malta are defined as family businesses, meaning that a family owns a significant share and can influence important decisions, particularly the election of the chairman and CEO.

Family businesses are often an overlooked form of ownership, yet they are all around us

As a professional accountant working in such an environment, experience has demonstrated that the best way to maintain a healthy balance between family life and my place within the family business is to follow these simple but essential tips.

DON'T MIX BUSINESS WITH PLEASURE

Business and personal finances are a bad combo yet we find that too many small business owners use a single account for both sets of finances; a problem that grows worse when such expenses hit the company's books. Such a scenario might not pose a threat to the first generation owner, however as children and/ or extended family members start to join the family business, the complexities involved could ruin both the family relations as well as the business.

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Another problematic facet of mixing business with personal finances is the Inland Revenue Department (IRD), who are nowadays taking necessary steps to ensure that, for example, luxury vacations are not claimed as business travel. If such actions are caught in an IRD audit, the business risks running into expensive taxes and penalties.

DON'T MIX BUSINESS WITH FAMILY

Mixing business with pleasure is one thing, but mixing business with family yields a different outcome altogether. Sometimes family businesses tend to collapse under the weight of high expectations, heavy internal politics and plenty of personal and professional baggage. Family businesses sometimes also lack professional decorum and governance, both within the family and the business itself. Although the workplace may be shared with relatives, it is still a workplace and it demands a certain amount of professionalism to run and operate smoothly. Family politics and family discussions are not appropriate and can make other non-family members uncomfortable.

Disagreements among family members can spill from the professional to the personal in a matter of seconds. The problem can be particularly acute with spouses in business together. A hostile family work environment can be tougher to handle since the members know exactly what buttons to press if they want to get their point across.

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OWNERSHIP

Many family businesses are privately-held holding companies with reasonably independent subsidiaries that might be publicly-owned, though in general the family holding company fully controls the more important ones. By keeping the holding private, the family avoids conflicts of interest with more diversified institutional investors looking for higher short-term returns. Financial policies often aim to keep the family in control. Many family businesses pay relatively low dividends because reinvesting profits is a good way to expand the business without diluting ownership by issuing new stock or incurring long-term debts such as loans.

In fact, some families decide to entirely shut out external investors from the business and to fuel growth by reinvesting most of the profits. This requires good profitability and relatively low dividends. Others decide to bring in private equity as a way to inject capital and introduce a more effective corporate governance culture.

To keep control, many family businesses restrict trading of shares mainly to direct family members. Through pre-emption rights, family shareholders would be allowed to sell their shares first to their siblings and subsequently to their direct descendants. In addition, the holding company could buy back shares from exiting family members if they are left unclaimed so as to prevent them from moving out of family control.

FULL FAMILY EMPLOYMENT

Another common mistake in family businesses occurs when the owner feels that it is in his/her responsibility to employ every family member who wants a job. Full family employment is not a realistic goal for a business since vacancies within the company have to be created according to the needs of the company. Also, generations that follow the founder, for example, may insist on running the company even though they are not suited for the job. Some family members are qualified to fill in organisational roles, but some clearly aren't. Rather than hiring people based solely on their DNA, hiring decisions should be based on the individual's experience, education and competency to fulfil job requirements. If you have a hard time turning down family members, find a non-related individual in your company to take the lead in personnel decisions. You may even consider helping non-qualified families gain the qualifications they need to fill the position at some point in the future.

It is likely that a family business reflects the founder's personal values, aspirations and attitudes and these characteristics should be passed on to the next generation as these are the factors that differentiate the family business from the rest. However, as the second or third generations grow up, because they are generationally moving further away from the founder, they may have their own aspirations and different values. Over time, the new family members who run the business may not share the same foundations as the first generation. Thus, a generation gap exists and this may cause further conflicts both within the family and within the business. Conflict resolution and appropriate development in relation to family business can overcome these challenges.

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SUCCESSION PLAN FORMALISATION

Ownership of shares in the early stages of a family business can be a relatively simple matter. All of the shares will typically be held by the founder and his immediate family. In order to protect their business and personal relationships, the founding owners should look into implementing a successful succession plan and establish a clear ownership policy. A majority of current businesses believe that members from the same family will control their business in the coming years, however research and statistics show otherwise. Only about 30% of family businesses survive into the second generation and only around 10% reach the third generation. Research also suggests that family business failures are mainly brought about by an unfortunate lack of family business planning.

Succession planning involves planning 'your end game'. Will you ultimately sell the business or pass it on to other promising family members? Who is to be considered as family for the objective of family business ownership? If one partner dies, do you want that partner's spouse or children to be your new partner? What are the requisites for one to join the family business? How can one exit the business? Transition problems are exacerbated when the current owner fails to adequately prepare for the transition by neglecting to name a successor early and decisively or by not deciding to pass on the baton.

Succession planning involves planning 'your end game'

DIFFERENT CLASSES OF SHARES

In its early stages, a family business normally has a relatively straightforward share structure with one class of ordinary shares held by few family shareholders. Different classes of shares can, however, be useful as the number of shareholders increases and the business becomes more complex. Here are some examples:

» Different income expectations of shareholders: Family shareholders who are not employed in the business may be more reliant on dividends than those who are. Internally, there may be a feeling that those who are not employed in the business should not have voting shares (or should perhaps have restricted rights). To deal with this, the share capital may be divided into different classes of ordinary shares that could have different rights to dividends, voting and capital; and preference shares which have a preferential right to a fixed dividend and rights on any return of capital but no voting rights (or restricted voting rights). A method which is often used is when the ordinary shares are owned by those employed in the business whilst the preference shares by those who are not:

» Passing down wealth but not control: The family business owner may be happy to pass down his / her wealth in the form of entitlement to dividends to the next generation but at the same time may be concerned that the next generation is not yet of age or mature enough to assume control of the business. One solution to this is for the share capital to be divided into preference shares carrying a preferential right to a dividend but no votes and no rights to capital; and ordinary shares carrying a non-preferential right to a dividend but full voting rights and rights to capital. The founder could then retain a majority of the ordinary shares but pass down all or most of the preference shares.

» Another option which is available is that the founder could consider putting the ordinary shares into a trust. In this case, one must be careful about clearly understanding the owner's objectives as trusts, despite being a very effective vehicle, could also disenfranchise the family members from their legacy.

INVESTMENT AND GROWTH

Beyond the core holdings, as the family business becomes stronger and wealthier, families would need to develop strong capabilities for managing their wealth wisely. One of the options could be to extract capital from a family firm and transferring it to an investment elsewhere e.g. in liquid assets, semi-liquid ones (such as investments in trusts, hedge funds or private-equity funds), and holdings in other companies. Diversifying the investment portfolio is very important, but it can be tough when the biggest share of the wealth is tied up in the family business. By diversifying risk and providing a source of cash to the family in conjunction with liquidity events, successful wealth management helps preserve family legacy and harmony. With the increase in wealth of family business this wealth management function is provided through the setting up of Single or Multi-family offices.

By diversifying risk and providing a source of cash to the family in conjunction with liquidity events, successful wealth management helps preserve family legacy and harmony

Many family businesses are excellent wealth generators and entrepreneurs may consider the risk of having all their financial eggs in one basket to be an inevitable consequence of building a business that they control. For some family shareholders, however, especially the ones who may not be involved in the running of the business, it can feel less comfortable. Investment advisers, too, might shrug off the idea of having a large portion of personal wealth and risk in a single unquoted company. One major obstacle to building a meaningful investment portfolio outside your family business is the difficulty of extracting the capital itself since many a time family businesses are asset rich but cash poor.

Many family businesses run their finances extremely conservatively with little or no gearing, modest dividend pay-outs and an overweight balance sheet. In many cases, capital extraction is perfectly achievable over a period of time and if sensibly undertaken. Even if it means you have to go to your bank for a loan, it can be worth it, given the benefits of a more balanced pool of investments.

Where it fits with your wider strategy, bringing in an outside investor may also make sense. This can work particularly well when you spot an opportunity for expansion. Specialist private equity investors are increasingly comfortable with taking a minority stake alongside a management team they believe in – and, contrary to received wisdom, are often happy to see their funding flow out of the business and into the family's personal wealth in order to "de-risk" the family's financial position ahead of a push for growth.

TAX PLANNING ISSUES

Tax is another concern for families seeking to spread their wealth across a wider portfolio of investments

When it comes to succession, how dependent are the current owners on the financial support of the business to maintain their lifestyle in retirement? Perhaps they think they can't afford to hand over the reins without causing a cash-flow crunch on the company or on them personally if they retire. Many times, we see 90% of a business owner's net worth locked up in the business with some real estate that's leased back to the business, and a basic amount of personal liquidity as well as the possibility of a basic retirement insurance plan. They made their fortune through concentration in the business, not through diversification. This can create a feeling of being held hostage to the business for future financial stability.

Another issue with the above scenario stems from tax planning implications. Tax is another concern for families seeking to spread their wealth across a wider portfolio of investments. If tax planning is left for the last minute it can have dramatic consequences on the family and the business. Holding an investment portfolio within the same structure as the family business muddies the water as tax reliefs are not available to investment companies. This may not be an issue if only a small portion of the company's overall capital is invested outside the business, but it's often safer to extract investment capital and hold it separately to avoid tainting the tax position of the trading business.

Distributing dividends out of the business for investment purposes would usually be prohibitively expensive, as most family members would be hit hard by income tax. With planning it is often possible to take investment assets into a separate structure without substantial tax costs. Therefore, developing such a solid cash-flow-based financial plan and coupling it with a business valuation can help develop the way forward. Knowing what the shared purpose of the next generation is and what type of owner one is, that is whether one values the protection of the family business legacy more over taking advantage of wealth or vice versa also helps.

CONCLUSION

Until one truly understands the root of why a family business owner is not willing to make a move in passing on the baton, it will be hard to help the current owners in planning out their life and doing new things outside the business. This proves to be a very hard role to play in one's position as a family business adviser since such scenarios may end up hurting some egos and stirring up some pain before an appropriate solution can be acted upon. The financial planning piece is the easy part. Addressing the family dynamics, management and psychological issues is where the real work begins and this should be the first phase in the planning process before any financial or ownership issues are tackled.

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A LEGAL TOOLKIT FOR FAMILY BUSINESSES

DR JEAN-PHILIPPE CHETCUTI

CHALLENGES FACED BY FAMILY BUSINESSES

From time immemorial, family businesses have faced recurring concerns in their good governance as well as in their succession planning. As a family business expands and members from new generations come on board, family businesses tend to collapse in the face of family conflict and unpreparedness unless clear established guidelines are already well set in place so as to help family members evolve their relationships within the family as well as with the business. Business governance aspects may often lack the formality and clarity normally found in non-family businesses so that business and personal finances are often intermingled, family members continue in their employment without any formal contracts of employment and several key issues remain unspoken taboo, including matters of authority, responsibility, accountability and succession. Business life events such as the handover of

Business governance aspects may often lack the formality and clarity normally found in non-family businesses

the reins of the business to a successor or the passing of ownership across generations could also potentially cause pain if not death and therefore call for careful preparation.

Amongst the homework to be done by business families to safeguard their business against these risks, one must address priorities such as:

» educating the upcoming generations and issues like the handing over of the management and ownership of the family business
» liquidating the retiring owner's share of the business whilst catering for the funding requirements for the firm founders and/or current generation
» planning the family business owner's involvement in the business after retirement.

Moreover, family businesses may face challenges that are of a fiscal rather than purely legal nature, including high transfer tax costs and cash flow problems as a consequence of the potentially sudden and crippling transition from one generation to another.

Whilst the preparation exercise is not entirely a legal one, family businesses do need to take into consideration a breadth of legal and taxation aspects that impact any of the concerns outlined above. In this article, I propose to highlight some fundamental tools that may be used in planning and governing the family business. Not every tool is appropriate for all family businesses and each family business has its unique circumstances, values and aspirations. The tools described below can be adapted to a wide spectrum of varying criteria.

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MATRIMONIAL REGIMES AND PRE-/POST-NUPS

Matrimonial regimes for the governance of financial affairs within marriage are regulated by the Civil Code and may be called upon to address some of these problems. The Civil Code establishes the matrimonial regime that shall apply by default, unless otherwise agreed by the spouses. The law states that "Marriage celebrated in Malta shall, in the absence of an agreement to the contrary by public deed, produce *ipso jure*, between the spouses the community of acquests". Spouses may agree differently by means of an ante-nuptial (pre-wedding) or post-nuptial contract. They may agree that their property acquired during their marriage shall remain separate or that it shall be governed by the system of community of residue under separate administration.

A prenuptial agreement has to be entered into before a notary and expressed in a public deed to be registered in the Public Registry with the consent of both spouses. The Court's approval is needed to amend a prenuptial agreement during marriage to ensure that such amendments are not prejudicial to the rights of children and third parties. Such contracts enable the parties to clearly design their economic affairs before or after marriage. Such agreements typically determine how spouses are included in the family business and which matrimonial regime is to apply after marriage. By making such an agreement, couples would be entering marriage with a clear mindset that protects their family and investments from the uncertainties of any turbulence that may arise within the marriage in future.

Maltese law provides for spouses to choose amongst three different economic regimes, namely the Community of Acquests, the Community of Residue under Separate Administration (CORSA) or the Separation of Estates. The Community of Acquests is the legal regime that applies by default in the absence of a public deed to the contrary. Such community includes all that is acquired by each spouse by exercise of work or industry during the marriage and also fruit deriving from paraphernal property. Therefore, if a business is created during the lifetime of the

> **Maltese law provides for spouses to choose amongst three different economic regimes**

community of acquests, the business together with all of the proceeds will belong to the community of acquests. Property bought before marriage, inheritances and donations are excluded from the Community of Acquests. Thus, if one spouse inherits the business from his or her parents, the business per se would be paraphernal, that is owned by the person who inherited the business. However, any fruits emanating from that business would belong to the community of acquests.

Spouses may also opt for the Separation of Estates regime that allows each spouse to retain full control over his or her estate

Spouses may also opt for the Separation of Estates regime that allows each spouse to retain full control over his or her estate. In such cases, the marriage creates one family unit but preserves the economical independence of the spouses. This regime ensures that the individual spouse remains the sole owner of any possession they had before and after marriage. By some, this is regarded as an effective way of protecting one spouse against liabilities or the insolvency of the other in that a spouse would not legally be required to make good for the debt of the other. In the absence of such election in a prenuptial agreement, creditors would have a right against the community of acquests that applies by default and therefore a right to turn to the other spouse's assets to seek repayment of their debt.

Under the CORSA regime all that is acquired by the spouses is administered separately, however, once such regime is terminated, all that has been acquired by the spouses will be merged and then divided between the spouses. Thus, under this regime, any property acquired during marriage by each of the spouses will be held and administered by the spouse making such acquisition. All the property that becomes co-owned through the regime of the community of acquests will also form part of the community of residue under separate administration. While such regime can be used when one or both of the spouses are involved in the business, this regime is rarely used in Malta.

OWNERSHIP TRANSFER MODALITIES

Another legal tool available to family businesses is the allocation of different rights to different classes of shares. Shares can be transferred either by sale or donation. The terms of transfer may include warranties and obligations applicable to the new shareholders for the better protection of the transferor and of the family business. Shares can be apportioned to the children in equal or different portions or exclusively to children partaking in the running of the business, while compensating non-business family members using other assets. When the transferring couple is regulated by the community of acquests, the transfer of shares is an act of extraordinary administration and therefore requires their joint consent.

The use of different types of shares and the creation of classes of shares can also lead to a more customised combination of ownership and management rights in the business

Founders or the current generation of the family business may choose to transfer shares by selling them to their children for a consideration on terms similar to a transfer to unrelated third parties. This has the effect of providing the current owners with much needed liquidity on retirement or of involving the incoming family members in the economic burden of the business in accordance with the core values of the family, where the family may consider this a good way of ensuring commitment to the business. Shares may also be transferred by donation and therefore as a gift to the children. At law, this is subject to the reserved portion rules protecting legitimaries under Maltese succession law.

The use of different types of shares and the creation of classes of shares can also lead to a more customised combination of ownership and management rights in the business. The use of preference shares entitles shareholders to be paid a fixed guaranteed dividend before any dividend is paid out to holders of ordinary shares. However, ordinary shareholders are not necessarily at a disadvantage as they are entitled to

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the residual profits and residual assets on an eventual liquidation. Ordinary shares allow equal participation in dividend rights, voting rights and rights to proceeds upon liquidation of the business. Ordinary shareholders are entitled to receive, by way of dividend, any profits available after dividends on preferred shares are paid.

Ordinary shares can be further subdivided into classes of shares having different rights. One may choose to grant the right to receive dividends and proceeds on liquidation to one class of shares, whilst rights to appoint directors and the rights to vote are granted to managing family members and managing third parties involved in the family business.

SHAREHOLDERS AGREEMENTS AND FAMILY CONSTITUTIONS

Share transfers are subject to the shareholders' agreement, which may be either separate or one with the family charter or constitution. This is an agreement entered into by the shareholders of the company and thus the company itself is an extraneous party, hence it is not bound by the agreement. Other shareholders who are not party to this agreement are also not bound by it. Typical clauses of such an agreement include pre-emption rights which are rights to purchase additional shares in the company before the general public, voting rights, signatories of bank accounts, arbitration clauses, etc. Another typical clause is the restriction on transfer of shares with the aim to preserve business within the family.

TRUSTS

The Trusts and Trustees Act defines a trust as "...where a person (called a trustee) holds, as owner or has vested in him property under an obligation to deal with that property for the benefit of persons (called the beneficiaries), whether or not yet ascertained or in existence, which is not for the benefit only of the trustee, or for a charitable purpose, or for both such benefit and purpose aforesaid". The third player in this relationship is the settlor, who is the person who settles property in trust.

Trusts are used for a variety of purposes and are often used in the context of family businesses as vehicles for the ownership and management of family businesses as well as the protection of the various categories of family members. Trusts can be used for the management of assets upon death and to protect assets from potential claims from creditors. This is beneficial in the case of vulnerable persons such as minors, persons suffering from any disability or illness. In this way, family wealth can be preserved by centralising control and administration of assets. Accumulated family wealth is not divided amongst a number of heirs but retained as one fund which can then accumulate further, protecting assets for subsequent generations. Having a trust can avoid a long probate process. Also, when shares of a family business are transferred to a trust prior to the settlor's death, this can save the family business from financial hardship that often results in the liquidation of the family company.

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WILLS AND SUCCESSION LAW

The estate of a deceased person is transferred by inheritance either through the express disposition of the individual in the form of a will (testate succession) or through pre-determined modes of disposition by operation of the law in the case of the absence of a will (intestate succession). A will is an instrument by which a deceased person disposes of his/her inheritance either wholly or in part.

Spouses have the possibility of leaving an *unica charta* will consisting of separate wills in one instrument, with the consequence that if one party revokes one part, the other part remains valid. It is otherwise not possible for two or more persons to draft a will in the same instrument.

In testate succession, the reserved portion rules have to be observed in all circumstances including the settlement of the family business into a trust, thus one cannot exceed the maximum distributable assets. The reserved portion is a right on a portion of the estate of the deceased that may not be disposed of by universal or singular title to any person since it is reserved by the law in favour of the descendants and the surviving spouse of the deceased.

Intestate succession, on the other hand, is succession where there is no will or else there is an invalid will. This can also arise in cases where the testator didn't dispose of the whole of his/her estate or else the heirs are unwilling or unable to accept the inheritance. The mode of succession contemplated by the law is based on the presumed proximity of the relationship between the deceased and his/her relatives. Accordingly, the estate of the deceased will devolve through the operation of the law in favour of the descendants, the spouse of the deceased, the ascendants, the collateral relatives, and, in the absence of these persons, the Government of Malta.

The main advantage of having a will is the fact that one regulates succession and the division of assets when one passes away. In a will, one can create specific dispositions such as legacies to determine the transfer of a particular asset to a particular heir, thus a family business can be left as a legacy.

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No doubt, the above tools can only be of use in protecting a family business if they are well thought out in advance of the happening of events that they are intended to cater for. Therefore, my advice to any family business is that it's never too early to start internal discussions and to consider the legal and tax implications arising in the family business context. Plan ahead!

FAMILY BUSINESS TRANSITION PLANNING: UNLEASHING THE TAX OPPORTUNITIES

KENNETH A. CAMILLERI

INTRODUCTION

Perhaps the most obvious transition plan for a family business is the shift from one generation to the next. Besides the issue of whether or not the next generation is willing to take this over, such transmission brings along with it serious planning, in particular due to tax implications which might arise.

There are many circumstances which could trigger the transmission of a family business, such as retirement, disagreement or death. As a result, various options exist in which a family business can be transferred, such as by means of donation or sale to one or more family members, sale to third parties, division, exchange of shares as well as by succession or via a trust.

Early planning for a family business succession is crucial

Particularly because there is such a wide range of choices, each with their own individual tax implications, early planning for a family business succession is crucial. When done diligently and

The two most common forms of family business transitions are either through inheritance or alternatively by retirement and handing over the business by means of sale or donation

timely, transition planning can ensure that a business is transferred to its new owners in the most tax efficient manner.

This article will attempt to highlight the most common paths along with some of the key tax and estate planning opportunities, specifically based on the laws of Malta to date.

The two most common forms of family business transitions are either through inheritance or alternatively by retirement and handing over the business by means of sale or donation.

CAUSA MORTIS TRANSMISSION

Here, we will look at the tax implications arising through inheritance, that is causa mortis transmission.

In a family business which is structured in the form of a limited liability company or as a partnership, the heirs would be subject to stamp duty.[1] The stamp duty applicable is that of two euro for every one hundred euro or part thereof of the real value of the marketable security or partnership interest, upon notice of such transfer causa mortis.

In the case where a company or partnership has seventy-five percent or more of its assets, excluding all current assets, consisting of immovable property or real rights thereon, then the rate of stamp duty differs. In such a case, the stamp duty applicable is that of five euro for every one hundred euro or part thereof of the real value or the marketable securities or partnership interest.[2]

INTER VIVOS TRANSMISSION – RETIREMENT - DONATION

Where a family member intends to retire from a family business, one potential option is to donate his/her share to other members of the family. In the case of a family business structured in the form of a company or partnership, the transfer of marketable securities or partnership interest by way of donation would be subject to duty on documents and transfers (hereinafter referred to as 'stamp duty') of two euro for every one hundred euro or part thereof of the real value of the marketable security or interest in the partnership.[3] The rate of stamp duty would increase to five euro for every one hundred euro or part thereof of the real value of the marketable securities or partnership interest in the case of a property company or partnership.

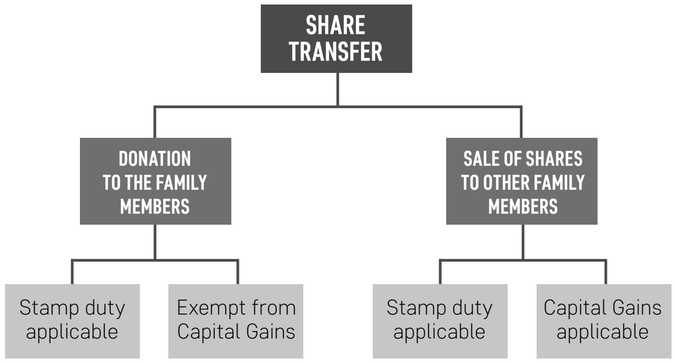
A property company or partnership is one which owns immovable property in Malta or any real rights thereon, or which holds shares or interests in another entity where 5% or more of the total value of such shares or interests is attributable to immovable property in Malta or real rights thereon.[4]

There is no capital gains tax imposed upon gains or profits derived from the inter vivos transfer of immovable property or business by way of donation to a person's spouse, descendants and ascendants in the direct line and their relative spouses.[5] In the absence of descendants, a donation to brothers or sisters and their descendants would similarly be exempt from capital gains tax. Furthermore, no property transfers tax would be charged in respect of a donation of immovable property made to such family members.[6]

TRANSMISSION THROUGH SALE OF SHARES

Tax implications would arise upon the transfer of marketable securities in a family company or transfer of interest in a family partnership by a family member to other family members or members of the general public for a consideration. Such a transaction would be subject to a stamp duty of two euro for every one hundred euro or part thereof of the amount of consideration or real value of the marketable security or interest in the partnership, whichever is the higher.[7] However, in the case of a property company or partnership, the rate of duty would increase to five euro for every one hundred euro or part thereof of the real value or consideration, whichever is higher.

Any capital gain derived from the sale of such securities in a family company or interest in a family partnership would also be subject to tax at the tax rate applicable to the transferor.[8] Capital Gain Transfer rules are applied to determine the market in order to determine the market value of the shares at the time of transfer.



OTHER FORMS OF TRANSMISSION

The transmission of a family business could also occur by means of a restructuring exercise in the form of a division, exchange of shares or transfer of assets from the family business to another company or partnership.

DIVISION

In terms of article 41A of the Duty on Documents and Transfers Act, an exemption from duty is envisaged where subsequent to a division of a company, the ultimate individual beneficial shareholders in the recipient companies remain the same shareholders of the company to be divided having the same proportion of shares in each recipient company as they held in the company to be divided. This exemption is unlikely to find scope of application in the context of restructuring of a family business as the whole purpose of the restructuring would be to create two or more companies whose shares are held in a different manner to the company being divided.

Similarly, the exemption from capital gains tax applicable in the Income Tax Act in the case of a transfer involving the exchange of shares upon restructuring by way of division is unlikely to apply in the context of transmission of a family business as the division must not produce any changes in the individual direct or indirect beneficial owners of each of the companies involved.[9] This would imply that any gain derived from the exchange of shares occasioned by the division of the family business would be subject to tax at the income tax rates applicable to the persons concerned.

TRANSFER OF ASSETS BETWEEN COMPANIES

Another way in which the transmission of a family business could take place is by means of the transfer of assets between different companies. The law envisages an exemption from duty on documents and transfers where an immovable property or any real right thereon is transferred from one company to another company if both companies form part of the same group of companies.[10] Alternatively, for the exemption to apply, both companies must be controlled and beneficially owned directly or indirectly to the extent of more than 50 per cent by the same shareholders.

Another way in which the transmission of a family business could take place is by means of the transfer of assets between different companies

Thus, the application of the exemption depends on the restrictions as mentioned above. Where a family member has the intention of completely departing from the family business, the transfer of assets would be subject to duty on documents and transfers and could also give rise to capital gains tax.

It is reasonable for the law to provide for a tax exemption in the case of divisions and transfers of assets within the context outlined above. Such forms of restructuring exercises are not typically driven by a profit-seeking motive, but are mainly intended to improve the efficiency and management of the business. The restructuring of a family business would normally seek to achieve these same objectives, especially in the case of divergencies between family members or to facilitate the smooth transition of the business from one family generation to the next. However, the restructuring of a family business may necessitate departure from the existing group structure and entail a change in the ultimate beneficial owners of the different companies. Nevertheless, the law should not automatically deprive the restructuring of a family business from the exemption applicable to a restructuring exercise even where the new companies do not form part of the same group or where new family members enter into the business as a result of the restructuring.

Where a family member has the intention to depart completely from the family business, the transfer of assets would be subject to duty on documents and transfers and could also give rise to capital gains tax

FAMILY BUSINESS CHARTER

In view of the different tax implications which may arise depending on the particular mode of transmission of a family business, as well as scenarios such as the previous, it is fundamental to plan upfront and as early as possible. This can be achieved by means of a family charter which outlines the procedure that is to be followed in the transfer of ownership and management of the family business. By means of such a charter, not only are matters seen from the tax angles, but psychological issues and business ethos are also addressed. This ensures a smooth transition as well as maintains harmony between the family members involved in the business, particularly when potential successors do not share the same qualities and interests.

CONCLUSION

Overall, this analysis shows that in many cases, passing the ownership of the family business to future generations triggers tax consequences. Whilst certain exemptions apply, very often stamp duty is applicable. Therefore, the transmission of a family business could create a considerable tax burden on the business itself, which despite being balance sheet solvent, could have difficulty in having at its disposal the liquidity required to meet its tax obligations as a result of the transmission.

In many circumstances, new owners have to rely on borrowing funds to pay taxes. Consequently, this impacts the business economically and can hinder future growth and investment.

One potential measure which could alleviate the liquidity problems that family businesses might face is to introduce a fiscal framework for the deferral of taxes applicable upon the transmission of the business inter vivos or causa mortis between different family members.

Another potential solution would be to extend the exemptions applicable in the context of restructuring of a group of companies to restructuring of family business where this seeks to enhance the efficient management of the business or to facilitate the smooth transmission of the family business from one generation to another. Moreover, it would also be desirable for the transmission of a family business by donation to be afforded a more favourable treatment than a commercial sale of a business in so far as stamp duty is concerned in order to suitably reflect the different objectives sought. These measures would alleviate the burden which family businesses could face in meeting their tax obligations occasioned by the transmission of the business, thus having more funds to invest in and consolidate their business investment.

Therefore the transmission of a family business could create a considerable tax burden on the business itself

This underlines the importance of preparing and planning in advance for the transmission with the assistance of tax professionals who can provide guidance whilst taking into account the domestic fiscal framework and any tax constraints.

REFERENCES

1 Article 42 (1) (c) and Article 42C (1) of Chapter 364 of the Laws of Malta
2 Article 42 (2) and 42X (2) of Chapter 364 of the Laws of Malta
3 Article 42 (1) (b) of the Duty on Documents and Transfers Tax, chapter 364 of the Laws of Malta
4 Article 42 (1) (b) of chapter 364 of the Laws of Malta
5 Article 5 (2) (e) (i) of the Income Tax Act, chapter 123 of the Laws of Malta
6 Article 5A (4) (a) (i)of chapter 123 of the Laws of Malta
7 Article 42(1) and article 42C(1) of chapter 364 of the Laws of Malta
8 Article 5 (1) (a) (ii) and (v)of chapter 123 of the Laws of Malta
9 Article 5(14) of chapter 123 of the Laws of Malta
10 Article 32(6) of chapter 364 of the Laws of Malta

THE USE OF TRUSTS FOR FAMILY BUSINESSES

DR PRISCILLA MIFSUD PARKER

INTRODUCING THE CONCEPT OF TRUST

In brief, a trust is a legal vehicle through which a person (the settlor) entrusts property to another person (the trustee) for the benefit of another person or group of persons (the beneficiaries). Therefore, a trust establishes a tri-partite relationship.

The trustee (usually a company authorised by the Malta Financial Services Authority to provide trustee services), who is provided with the trust property, is bound to hold such property under the main obligation to deal with such property for the benefit of the beneficiary, which beneficiary may not be as yet ascertained or in existence at the time of the creation of the trust. While the settlor no longer remains the owner of the trust property transferred to the trustee because the trustee becomes the owner, such trust property constitutes a separate fund. Therefore, the trust property which is owned by the trustee will invariably remain distinctly and separately owned from the trustee's personal property or from any other property which such trustee may hold under another trust.

The powers of the protector cover matters such as the appointment of a new or additional trustee, the removal of a trustee and obtaining information as to the way in which trustees are managing the trust

In view of the fact that the trustee is vested with the ownership of the trust property, the trustee is vested both with full power but also with the duty to administer the trust property in accordance with the terms of the trust deed and any special duties which the law imposes on trustees.

The terms of the trust may provide for the office of protector of the trust. The powers of the protector normally cover matters such as the appointment of a new or additional trustee, the removal of a trustee and the obtaining of information as to the way in which trustees are managing the trust. In the exercise of his office, the protector shall not be deemed to be a trustee.

The setting up of trusts in Malta is regulated by the Trusts and Trustees Act. The Act provides for the creation of trusts and authorisation and supervision of trustees. In this regard, the MFSA is the competent authority for the purposes of the Act. The Act incorporates within its provisions the Hague Convention on the Law Applicable to Trusts and on their Recognition which Malta has ratified.

CREATION OF TRUSTS

A trust can come into existence by a number of ways. A trust may come into existence by an instrument in writing including by a will. A unilateral declaration of trust is also possible. A unilateral declaration of trust is a declaration in writing made by a trustee stating that it is the trustee of a trust, containing all terms of the trust as well as the names or information enabling the identification of all beneficiaries.

A trust may also come into existence by oral declaration, with the exception of a unit trust which must be created by a written instrument. A trust may also come into existence by operation of law or by a judicial decision.

In the case of assets being held, acquired or received by a person for another on the basis of oral arrangements of a fiduciary nature, express or implied, there shall be presumed to be a mandate or a deposit rather than a trust, unless there is evidence of the intention to create an oral trust.

A trust may continue until the 125th anniversary of the date on which it came into existence, and, unless sooner terminated, shall terminate.

KEEPING THE FAMILY BUSINESS IN THE FAMILY THROUGH THE USE OF TRUSTS

The types of trusts available to families are living trusts and testamentary trusts. A living trust is one which has been set up during the lifetime of the settlor whilst a testamentary trust is one that takes effect on the demise of the settlor and provides for the beneficiaries to become so after his demise.

Malta recognises three main types of trusts. These are express trusts, implied or resulting trusts and constructive trusts. In an express trust, the settlor clearly delineates in the trust deed who of the beneficiaries should benefit and to what extent. An express trust is typically set up in writing. Implied or resulting trusts are trusts arising from the intention of the settlor, which intention is presumed from his words or actions. Constructive trusts arise by operation of law and arise as a means to avoid a person's unjust enrichment.

Using trusts in the scenario of a family business could help in the protection of the family business by passing on the business in an intact status from one generation to another. No owner of a business would want to see his business divided or closed just because his children are not in agreement on the way the business should be managed or owned. Holding the shares of a family business in a trust structure offers asset protection and estate-planning advantages. Protection

Using trusts in the scenario of a family business could help in the protection of the family business by passing on the business in an intact status from one generation to another.

of the family business shares is an immediate advantage in scenarios where marital separation, divorce, incapacity of family members or insolvency occur.

Another main advantage of using a trust in a family business scenario is that of proper governance of the ownership of the shares and how this should be passed on to the following generations. The first generation family members will need to clearly outline the manner in which the ownership and governance structure of the business will be regulated while going forward. In scenarios where family members are not involved in the governance structures of the business but they are still featuring as shareholders of the business, then the trust is a very efficient tool whereby these family members can be appointed as beneficiaries without any involvement in how the business is run.

Another main advantage of using a trust in a family business scenario is that of proper governance of the ownership of the shares and how this should be passed on to the following generations

Having a professional trustee who is not a family member and is not involved in the day-to-day running of the business but whose main aim is that of protecting the business for the benefit of the beneficiaries means that the business is able to attract third party individuals with key skills to work for the business without creating conflict situations with existing family members who expect to be awarded these positions without the requisite skills, expertise or experience. Having an independent trustee to take these decisions would diminish the possibility for conflicts within the family. Family businesses are often set up as a trust so that each family member can be made a beneficiary independently of whether they have any involvement in how the business is run.

Family meetings are also an important aspect with the aim of fostering a healthy family dynamic and trustees can assist in the setting up and conduct of family meetings. During these meetings, family members are informed about, and go through the process of seeing in practice, the functioning of a trust scenario and understand better the roles of the trustees, protectors and beneficiaries. The trust also gives an opportunity to family members who are not involved in the day-to-day running of the family business to have central roles in the trust structure by, for example, being appointed as protectors of the trust.

A family trust may be defined as a trust which is specifically created to hold property... for the purpose of safeguarding the present and future needs of family members or family dependants

FAMILY TRUSTS

A very recent amendment to the Trusts and Trustees Act this year embraced the notion of family trusts in Article 43B.

A family trust may be defined as a trust which is specifically created to hold property settled by a settlor or settlors for the purpose of safeguarding the present and future needs of family members or family dependants whose identity is definite and ascertained. Up to this day, the Trusts and Trustees Act does not provide a fixed definition of the terms 'family members' and 'family dependants'. It is a company whose object and activities are limited to acting as trustee in relation to a specific settlor(s) and provides administrative services in respect of the family trust. Every company which is a family trust shall necessarily be registered as a private limited liability company with its specific status, otherwise no company shall act as a trustee for a family trust.

While the person acting as the trustee of the family trust may hold the office of trustee in respect of other family trusts, such person is no longer allowed to act as a trustee to more than five trusts simultaneously or act as a trustee to the public.

It is understood that the intention of the legislator behind the introduction of 'family trusts' in Malta was to protect the existence of family wealth by providing an additional level of protection to family businesses. In view of the above discussion on family businesses in Malta and their active and dynamic role for our economy, it was only a matter of taking the step to introduce certain formalities in the operation and management of family businesses. The notion of 'family trust' in effect is intended to address the practical dilemmas which family businesses encounter and stumble on. Moreover, it also addresses the constantly emerging challenges and constraints which family businesses face in an ever-changing business sphere through the imposition of higher standards and regulations as well as increased competition.

ADVANTAGES OF FAMILY TRUSTS

While a family trust is specifically designed to safeguard the family wealth, it still offers adequate opportunities for different family members of different ages, skills and experience to be involved within. Since the trustee remains responsible for the protection and investment of assets which are settled on the family trust, the trustee is bound to oversee that the decisions made by the different family members involved do provide a long-term oversight in the best interest of the family trust.

> While a family trust is specifically designed to safeguard the family wealth it, however, offers adequate opportunities for different family members of different age, skills and experience to be involved within

In view of the idiosyncratic nature of every family trust, while the trustee remains ultimately responsible for the protection and investments of the assets settled on the trust, the trustee is at liberty to make his/her decisions based on the advice deriving from an investment advisor or investment manager. The trustee needs to be also backed up by the right legal and financial advisors to maintain the family business in good standing and to provide for proper restructuring exercises where required to pass on the business from one generation to another or indeed to split the family business into the separate branches of the family or merge the different family business entities into one in order to achieve economies of scale. In addition, the trustee is also the responsible person for ensuring full compliance with the anti-money laundering and counter-terrorist financing regime both from a national and an international perspective and this is where professional advice from the legal team becomes important. The trustee is also bound to keep up-to-date financial statements and accounting records in order to be able to render a holistic financial history and future financial projections to the family members within that family business.

Hence, a family trust would suit any family which is desirous of investing its assets by being actively involved in the process but which is also disposed to consent to a more authoritative role of the trustee so the real needs and interests of the family are determined objectively.

> Local providers excel at international legal and tax optimisation and are usually entrusted with the tax-efficient structuring of their clients' Malta and international assets

FAMILY OFFICE SERVICES

Most high net worth individuals and families hold widely diversified asset portfolios, entrusting management of security portfolios to various banks and assets managers and making direct investments in real estate, direct equity holdings and art collections. Legal advisors can act as the client's family office. Family office service providers act as neutral partners, providing comprehensive and transparent reporting for the various asset holdings while at the same time acting at their own initiative to spur clients when important decisions need to be taken.

Local providers excel at international legal and tax optimisation and are usually entrusted with the tax-efficient structuring of their clients' Maltese and international assets. In Malta, family office set-ups are very few and they pride themselves in having both the competence for excellence in results but also the values and integrity to handle important business transactions on behalf of the family.

THE VALUE IN LEGISLATION FOR FAMILY BUSINESS

DR NADINE SANT

Europe's rich history of family businesses makes it no mystery as to why the continent hosts many of the world's most successful family-owned enterprises. They have been highly influential not just in Europe's economic development but also, in many cases, in its social development. If the ancient Egyptians are considered to be the first example of sophisticated civilisation on Earth, then it could be said that family businesses may well have their origins in the Middle East. From a European perspective, Europe has some of the oldest family businesses in the world that date back to the year 1000 and in some instances that are still in existence. If we take a glance at the English Monarchy, we understand how that kind of joint family standing, a combination of business and land ownership, creates a brand and regime in itself. The British Monarchy or Family Firm, as Prince Philip once referred to it, can teach us a few things about business and about the importance of governance and succession. The

Europe has some of the oldest family businesses in the world dating back to the year 1000 and in some instances still in existence

Royal Family is certainly not the only European family with a rich history. Europe-based family businesses have been highly influential, not just in Europe's economic development, but in its social development too. Today, many of the merging family businesses can be particularly seen in Eastern Europe.

Probably the two biggest are Volkswagen and the Italian investment company, EXOR, owned by the Agnelli family

Of the world's 250 largest family businesses, a third are located in Europe. In fact, 85% of the companies in Europe are family-owned. Probably the two biggest ones are Volkswagen and the Italian investment company, EXOR, owned by the Agnelli family. Together, the family businesses of Europe employ a staggering 144 million people. If we look at North America, the figure is even higher whereby 90% of companies there are family-owned. To this end, one of the greatest success stories of modern times and a hallmark of the American dream is Walmart. It was just over 50 years ago that Sam Walton opened his first discount store in Arkansas. Although Walmart has grown at a steady pace, it is still owned by the Walton family. Today, it operates in 27 countries and, according to the Fortune Global Five Hundred list, Walmart is the world's largest company by revenue. It is worth pointing out that many of the privately-held family businesses in the United States and Canada are in their second generation of family ownership or beyond, which has to be testament to the resilience of this type of business.

Looking around the globe, 90% of the companies in the Middle East are family-owned businesses. They control virtually all of the oil producing companies operating in the Gulf. 85% of the companies in Asia-Pacific are family-owned, while in Australia the figure goes as high as 71%.

One thing that seems to be true the world over is that family-run businesses don't blow their own trumpets. They are as unlikely to sing their praises publicly as they are to complain too much when the going is tough. They are very private and don't like to draw attention to themselves.

Multigenerational family operations, sometimes with centuries of commercial nous, are more prone to ride out the storms than to express too much dissatisfaction about the current state of affairs. But as governments around the world oscillate on which fiscal policies to follow and businesses struggle under the weight of unwieldy regulations and inefficient tax codes, family businesses are becoming more vocal.

Some Australian family businesses have publicly said that their government is not giving enough support and is failing to differentiate between family firms and small-to-medium enterprises. This is despite the fact that some of the country's biggest companies, such as the Westfield chain of shopping centres and the mining giant Hancock Prospecting, are family-owned.

Last year, Family Business Australia produced a report to government entitled "Family Businesses in Australia – Different and Significant: Why they shouldn't be overlooked." One of the most promising recommendations of their report was that a legal definition of family businesses be established. Should this happen, it could signal that the Australian government was considering family firms more carefully in its policy-making. The report asked the government to gather comprehensive data on family firms and assess how legislation might affect family firms differently to other types of companies.

As an offshoot from this, we see that more family businesses are choosing to formalise their governance structure more than before. Family councils and charters, business charters and advisory boards are all attracting more attention. Family businesses that continue to prosper from one generation to the next often do so because they have robust governance

Family businesses that continue to prosper from one generation to the next often do so because they have robust governance structures

structures. Nevertheless, other family businesses have not given enough thought to governance. They rely too much on a carefree attitude toward issues such as succession, ownership and management, and they wait until one of these issues becomes an unavoidable problem before attempting to deal with it. The point of realisation comes too late, and the business ends up suffering as a result.

Some of the more common governance problems that can arise within family businesses are:

» Succession and dependence on their owner/s;
» An unwillingness to relinquish control when it would benefit the business to do so;
» Internal family conflicts;
» The assets of a business being abused by family members for their own personal benefit;
» Nepotism, and discouraging non-family business staff;
» Tunnelling – a situation in which family owners create a complex set of ownership structures that undermine non-family minority shareholders. This can ultimately damage the efficiency of the business.

Other concerns are:

» Who can or cannot be a shareholder;
» What are the different classes of shares;
» How are the owners to be represented on the board;
» How will the owners set objectives and challenge management;
» What are the important issues on which the management should consult the owners;
» What are the rules on exits for shareholders, and so on.

It is an interesting observation that those operating in consumer markets often promote themselves as family businesses but this is rarely the case in other types of industry, such as engineering or construction. Some observers point out that as countries emerge from recession, the aura of stability and continuity associated with family ownership is just the sort of thing to inspire confidence and fill order books.

Although family participation is critical for business growth, the family structure itself weakens as companies enter their third or fourth generation. This, of course, hampers growth. In generation one, the owner manages the company. In generation two, it is the sons and daughters. The third generation is where it all gets complicated.

In some cases, the challenges posed by 'family expansion' are exacerbated by the fact that family constitutions are rare. A family constitution is an especially sensitive issue in second or third generation families where the founder is still alive and succession becomes problematic and as a result many families have informal verbal codes or understandings that guide their businesses.

Even in families with a constitution, if the founder of the business still holds power, the constitution is often ignored when it contradicts the will of the dominant member of the family. Such lack of institutionalisation can make the family business an unattractive option for the next generation. In the third generation, successors start moving away and setting up their own companies.

Despite this, a number of families are finding ways to address the issue of youth flight. Some companies are using stock offerings as a way to reorganise power and wealth across a growing family empire. In fact, listing on a stock exchange would give some of the third generation the option of cashing out.

A family constitution is an especially sensitive issue in second or third generation families where the founder is still alive and succession is an issue

With wealth management and formal governance mechanisms not yet fully entrenched as practices among the business elite, it should come as little surprise that the family office structure has not taken hold. More telling than the fact that many family businesses do not have a family office is the fact that more than a third of them have never heard of a family office.

The next generation's openness to family offices might be connected to their greater use of wealth management services

Family offices face several challenges as much of the wealth is new in Malta, and many first and second generation wealth builders remain more focused on developing their businesses than preserving their wealth. Unsurprisingly, the proportion of third and fourth generation family members, or the next generation as we label them, willing to consider establishing a single or multifamily office, is far greater than the cross-generational average. The next generation's openness to family offices might be connected to their greater use of wealth management services. Almost two thirds of next generation participants use wealth management services frequently or occasionally, much more than the overall participant average of about 50%.

While trust is an important factor across generations when selecting wealth managers, the next generation gives 'investment track record' equal importance, twice the rate attributed by earlier generations. Coupled with higher rates of educational achievement as well as international travel experience, the next generation of wealth builders appears to be primed to adopt more sophisticated business and wealth management mechanisms.

Many next generation wealth builders identify the need for more formal structures in organising family wealth. Whereas on average only half of all family businesses adhere to a corporate code or plan to implement one, almost all third and fourth generation wealth builders have implemented a corporate code into their business.

The third generation wants formal arrangement and protocols. They understand the changes brought about by globalisation and they are looking abroad for inspiration. They don't want narrow, conservative companies. These younger family members are taking a step closer to family offices by trying to motivate their financial service providers and trusted family lawyers to establish structures to provide some of the services of a family office.

> These younger family members are taking a step toward family offices by trying to motivate their financial service providers and trusted family lawyers to establish structures to provide some of the services of a family office

From a legal business model perspective, purpose trusts, private trust companies, family partnerships, limited liability partnerships and protected cell companies generally provide the building blocks for family holding structures. This is a sign of intensifying competition among jurisdictions. As a result, many are expanding or upgrading their legislative arsenal to cater specifically for high net worth families and this is currently one of the most innovative areas of offshore legislation.

Hong Kong has just followed Singapore by modernising its trust laws, while Guernsey, Jersey and the Isle of Man have all introduced foundations to broaden the fiduciary options to civil law jurisdictions. The Bahamas Executive Entity was introduced specifically to control and protect decision-making at the top level of a structure. It is also interesting to see that Luxembourg and Qatar have followed Dubai by introducing a specific regulatory framework for family office activities.

Dubai has introduced the legislation on the Single Family Office Regulations which specifically addresses the needs of family-run institutions and governs the registration procedure and documentary requirements for a single family office.

The regulations offer distinct benefits to single family offices by excluding them from many of the regulatory restraints placed on conventional financial institutions of the Dubai International Financial Centre. This occurs on the basis that single family offices have no direct public liability.

Confidence in market conditions among the family business community is clearly on the rise

A single family office may be incorporated or established as a body corporate or a partnership for the purpose of providing services to a single family. It must comprise either one individual or a group of individuals who are the bloodline descendants or a common ancestor and must own a minimum of $10 million in investable or liquid assets.

In 2012, Luxembourg introduced a specific regulatory framework for family office activities under the Family Office Act. This states that family office activities consist in providing, on a professional level, patrimonial-related advice or services to private individuals, families or patrimonial entities founded or owned by, or benefitting, private individuals or families. A draft law that was submitted to Luxembourg's parliament in July last year is addressing the lack of legislation around foundations. The new orphan tax structure "foundation patrimonial" has no members, shareholders or associates and is aimed at broadening the range of investment vehicles for high net worth individuals in Luxembourg.

So, where are we now?

Confidence in market conditions among the family business community is clearly on the rise and visible from survey results. This year, more respondents have been willing to state their view as positive, as opposed to neutral, and for this market segment, all the signs point to market confidence being restored even with a war on talent playing out in the background.

There are many reasons for increased confidence, not least the changing funding landscape. Access to finance and credit is no longer as big a concern as it was six months ago. A willingness to re-invest profit and the ability to secure bank funding is on the rise.

Understandably, we should recognise that while access to finance is improving, it is not the same experience for everyone. For some family businesses, it is still a struggle.

In drawing up legislation for family businesses, observing what the European Union has to say on business transfers is elementary. To this end, the European Union has campaigned to encourage the creation of legislation and a framework of transfer-friendly regulations. And, of course, it all begins with money. The European Commission recognises that buying an existing business often requires more capital than starting up a new business. Assisted loans, guarantees and forms of equity capital for a limited period could make it easier for a larger number of potential transferees to take over businesses.

Then, there's the creation of business advisory services. As business transfers touch upon complex problems such as succession legislation, taxation, preparing the company for sale, price evaluation, etc., advice from specialists such as business consultants, tax auditors, lawyers, accountants, banks and notaries is needed to carry out the process.

Training is important for increasing entrepreneurs' knowledge of business transfers and their readiness to carry one out

Training is important for increasing entrepreneurs' knowledge of business transfers and their readiness to carry one out. Specific training courses on business transfers for both transferors and successors will provide the entrepreneurs with the knowledge and tools to plan to implement the transfer process. These and others are an indication of suggestions from the European Commission which are being taken on board as the legislation is developed.

To date, no other member state has formally recognised in standalone legislation the transfer of a family owned and run business to the next generation, as we in Malta are proposing. In some jurisdictions, a soft reference is made to family members but none define family business or formally assist in the transfer from one generation to the next – the hinge which matters most. The scope of this unique legislation is to assist and facilitate the transfer and ownership of the family business from one generation to the next without hindering the continuity and development of the business. It is imperative that development is encouraged and it is equally vital that there is continuity in the event of the owner's or an associate's death. Legal restructuring must be given a smooth path in order to avoid liquidation.

Financing is, undoubtedly, another important aspect. Guarantees for equity or quasi equity fund investments in SMEs should include investments by local or regional funds which provide seed capital and/or capital in the start-up phase as well as mezzanine finance in order to reduce the difficulties which SMEs face due to their financial structure, and those arising from business transfers.

Operating such an innovative structure entails significant costs both from a human resource, physical resources and capacity building perspective. A regulator or manager will coordinate and administer the legislation, its functions and duties.

Operating such an innovative structure entails significant costs both from a human resource, physical resources and capacity building perspective

One of the functions that the legislation needs to provide is for a central reference point that will be raising awareness, since one cause of major problems in business transfers is that the planning for the process starts too late.

The Family Business Act will be distinctive not only in its legislative scope and intention but unique to the legal community on a European and International level. While this allows for a wide vision, the disadvantage lies in the fact that accurate and tangible research, statistics and data are either negligible, non-existent or irrelevant. Research, statistics and data need to be gathered not only at inception but also during the operational stage to monitor the growth, success, or failure of the legislation. To this end, the initiation and start-up depend entirely on financial assistance from the government. The beneficiaries of this legislation will be widespread because nearly the entire business community could potentially be eligible to benefit from this legislation. In addition, we must recognise that foreign family businesses, who opt to register their business in Malta, will also become valid beneficiaries.

Whilst this legislation is commendable for addressing concerns emanating from the European Commission, family businesses and government policy, this legislation and its success must be seen as a marathon not a sprint, whereby its true test of success will be calibrated in the generations to come.

A GUIDE TO A FAMILY BUSINESS CONSTITUTION

MARIO DUCA

Those family enterprises who have become successful are very different from others, but they have at least one thing in common; they have managed to become well organised. Their success boils down to the fact that they have invested time, energy and resources in developing clear planning and a way of how the family members will relate to each other and the business.

The term 'Family Constitution' could sound too overbearing especially for the smaller family businesses, but actually all family businesses, whatever their size, have unwritten versions of the 'family constitution'. This will be reflected in the blending of assumptions, understandings, expectations and life aspirations that exist in every family in business and how things are done within that family.

> All family businesses, whatever their size, have unwritten versions of the 'family constitution'

The major problem with this type of informal arrangements is that with time, the family and the business usually become more complex.

If not properly managed, over generations ownership becomes more fragmented and the business itself changes as a result of diversifications into other assets or activities

This complexity is reflected through the growth of the family and their enterprise. If not properly managed, over generations ownership becomes more fragmented and the business itself changes as a result of diversification into other assets or activities.

Therefore, retaining the initial informal understandings could be very dangerous for the future health, wealth and happiness of the family and their business. A major decision has to be taken by the family regarding whether to keep the status quo through the informal agreements, understandings and assumptions with the hope that the family blood will stand the test of time and everything will continue to work, or else invest resources to get things written down.

In the following sections, I will be outlining the salient points of the Constitution and hope that this will help the reader to decide in favour of having a clearer and more organised way of managing the family relationships and dynamics thereby directly reducing the risk of conflicts within the family and the business.

THE FAMILY AND THE BUSINESS

We are often asked to clarify the meaning of the term 'family business'. The European Family Business Expert Group adopted a common European definition, according to which a firm, of any size, is a family business[1] if:

» The majority of decision-making rights is in the possession of the natural person(s) who established the firm, or in the possession of the natural person(s) who has/have acquired the share capital of the firm, or in the possession of their spouses, parents, child or children's direct heirs.
» The majority of decision-making rights are direct or indirect.

» At least one representative of the family or kin is formally involved in the governance of the firm.
» Listed companies meet the definition of family enterprise if the person who established or acquired the firm (share capital) or their families or descendants possess 25% of the decision - making rights mandated by their share capital.

Family businesses can be very diverse: they can be small, medium sized or large, listed or unlisted.

This definition could mean one nuclear family, a multi-generational family or a network of families where the business is owned, in its majority, by the same family and where that family will have the power to control the direction of the business. Over time, business families end up diversifying their interests into diverse assets and activities that they share together such as land and property development, financial investments, hotels, leisure assets, manufacturing, IT, and so on. In view of this developmental process, it is understood that practical solutions have to be devised so as to seamlessly manage and organise this wealth and legacy. This can be achieved through the development of the 'Family Constitution' which would regulate all this, irrespective of size and amount of wealth. What changes would be the detail and complexity of the Constitution.

Informal agreements encountered in many a family business, could over time pose a risk to the family if they are entirely based on understandings, assumptions and expectations

THE INFORMAL CONSTITUTION

Informal agreements encountered in many family businesses could over time pose a risk to the family if they are entirely based on understandings, assumptions and expectations. When put under duress, these in turn could result in misunderstandings, mistaken assumptions and unfulfilled expectations. Some scenarios that reflect the above are statements we have heard throughout our career: a parent to his offspring would say: 'I

> As such, families who want to reduce conflict have to plan in advance rather than leave everything to chance and therefore they would prefer a formal written Family Constitution

assumed you wanted to work in the family business', or a family member to his family would say: 'I thought that my wife would get a job in the family enterprise as happened in the case of my brother', or a comment made by the elder of the siblings, 'I had expected to become the next CEO and the majority owner'. Very often, these misunderstandings occur because of discussions that would have been held informally as a result of some hot issue that would have arisen at a specific point in time. Many a time, they would have taken place between different generations who have different views about wealth and work-life balance. If not pre-empted, these situations could easily degenerate into destructive conflict.

As can be expected, when the interests and ambitions of a family overlap with those of its business, complex issues will arise and if one does not have a clear way of how to manage these difficult scenarios, the family will end up in conflict due to the arising personal interests and lack of trust involved. As such, families who want to reduce conflict have to plan in advance rather than leave everything to chance and therefore they would prefer a formal written Family Constitution. They also tend to be very pragmatic persons who assume that there will definitely be different views and opinions on a number of points such as succession, ownership, employment, remuneration, valuation of assets, and so they prefer to debate these issues calmly before they arise and write them down into a formal, legally-binding Family Constitution.

Although business governance structures as well as rights and responsibilities are established in accordance to legal requirements (such as through the Memorandum and Articles of Association), these by themselves may not suffice to prevent damage to the family wealth as a result of tensions, disputes and in some cases extended court battles.

Sometimes due to the speed at which families change, fixed structures such as trusts and business governance structures would be insufficient to foresee or to address problems that can arise in a family or the family business dynamics. For example, the death or divorce of a family member can paralyse and produce major problems and uncertainty for the family members who have a stake in the family wealth.

The Family Constitution as well as the principles and protocols that form it, if well-developed, can help anticipate issues that may be faced and provide the appropriate forum and guidelines to deal with those that will arise from time to time even if unexpected.

WRITING A FORMAL FAMILY CONSTITUTION

Many families in business think that they already have adequate corporate governance practices and structures through shareholder agreements, a Board of Directors, investment and distribution policies, buy-sell options or well-crafted trust documents. However, these normally focus on the formal legal rights and responsibilities that arise in relation to the vested interests in business and the operation of the business. What about the interests of the family?

These are generally structured in such a way that they do not cater for the individual differences one finds within the diverse family businesses, the different dynamics or the family members' relationship with the business and the family.

The advantages of writing a family business constitution are that it provides for a better coverage of the jurisdiction in which family governance will be administered and it expresses the principles and objectives that the Family Constitution will require family members and other interested parties to adhere to.

If well written, the Family Constitution will include a number of provisions for dealing with particular events such as the death of a key person in the family business, matrimonial litigation, ability of heirs to manage the business, share transfers and share donations, amongst others[2].

Having a legally binding document provides for better peace of mind between family members and greater effort will be exerted to abide by what has been agreed and signed for

LEGAL STATUS

Unfortunately, many a time the Family Constitution is expressed as a non-binding document but this would reflect the lack of understanding of the person developing such a document. The Family Constitution should be structured as a legally-binding document, otherwise no one having signed such an agreement will feel obliged to abide by that document. At the same time, having a legally-binding document provides for a more holistic peace of mind between family members and greater effort will be exerted to abide by what has been agreed and signed for.

The Family Constitution should be a key guide for all parties involved and if necessary during Arbitration or the Courts, it should be utilised to interpret the conduct of the parties and the actions and decisions that may have been taken.

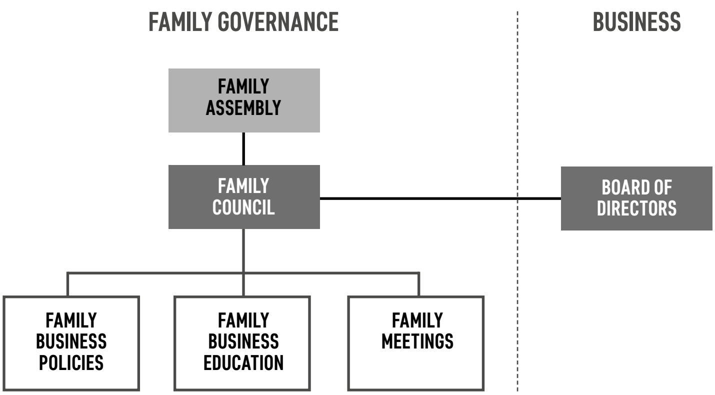
FAMILY GOVERNANCE WITHIN THE FAMILY CONSTITUTION

Family issues will always affect the business and it is futile to try to treat the family and the business as if they were separate entities. As the family grows, so do the complexities within it and therefore the governance of the family becomes as important as the governance of the business, if not more. This is achieved by the setting up of the Family Assembly which is clearly defined within the Family Constitution.

The Family Assembly is a forum where the concerns and interests of the family can be discussed and addressed. This forum is a flexible structure which is designed to fit the needs of different families but at the same time, it is very important to clearly define its tasks and goals. As the family grows through the generations and becomes more complex a Family Assembly can act as a vent valve to release the frustrations that are otherwise suppressed. Unfortunately, the importance of such a forum is more appreciated by families as they experience the angst within their ranks, than by advisers who tend to devalue the importance of establishing the social role of the Family Assembly. The role of the Family Assembly is often to formulate family policies that affect current and future generations.

Such policies could take the form of philanthropic activities, aspects of the family relationship with the business, such as employment and remuneration policies, the communication channels to be used between the family and the business, and conflict resolution procedures to be adopted by the family when and not if conflicts arise. Furthermore, the Assembly plays an important role in the education of current and future generations so that they will be fit and proper managers and owners of the family wealth, while at the same time increasing the awareness of business practices within the family.

GOVERNANCE



With the increase in family units and family members over generations, it becomes helpful to appoint or elect a separate group entrusted with the running of the Assembly and acting as the main governance link between the family governance and the business governance such as the Board of Directors. This separate group is referred to as the Family Council.

OWNERSHIP ISSUES

The Family Constitution should clearly set out who can be an owner within the family business and the roles and responsibilities of those owners. Amongst the most salient points will be that of establishing how the family will treat their earnings, that is how much to retain and those amounts that it will distribute as dividends. This clarity is very important as the family will have to ascertain that it is achieving a balance between owners who expect their investment to produce a market rate of return (referred to as value-out owners), and those who give importance to long-term sustainable returns instead of short-term returns (referred to as stewards or custodians). As can be appreciated, these two owner types will have a major effect on the financial flexibility that a business will have and consequently, a clear understanding of the family's position in how to treat these two interests is very important. It is not that one type is better than the other but that establishing a clear position is key.

Amongst the most salient points will be that of establishing how the family will treat their earnings, that is how much to retain and those amounts that it will distribute as dividends

An area that could create conflict is that which relates to who will be allowed to become an owner. Some families allow only bloodline descendants to become owners, while others allow spouses and partners. There are comments both for and against making spouses and partners owners in a family business but one must also keep in mind today's changing definition of a family and the issue of separations and divorces. Hence, if a family opts to decide to allow spouses and partners become owners, it must also develop safeguards so as to protect its members against the scenario that its assets will start being siphoned out of the family as a consequence of a divorce or separation.

Another issue that consultants are asked relates to the question of what happens to shares in the family business in the event of marital breakdown. Hence, one has to carefully plan how to pass on ownership as it could make considerable differences in case a court is to decide on what is to be considered as 'Matrimonial Property' and what isn't. These issues have been the cause of lengthy litigation processes, in which in some cases the business was held to ransom due to the warring parties.

THE FAMILY CONSTITUTION

The Family Constitution is a document that engages all involved, that is, the family members, family business, family ownership, family investments and family trusts. Through the sections that will be highlighted, all interested parties will play a vital role in ensuring the smooth governance of the family's affairs and business. Through the guidelines that will be set out, the family will avoid the kind of devastating disruption and damage that family conflicts can create both for the family and for the business. The major sections include[3]:

Section 1: The Family's Shared Purpose

» This is a statement clarifying the reasons why the family wants to stay in business together

Section 2: Family Governance

» Who is family and the role of family members
» The structure of the Family Assembly and / or Family Council
» The policies that the Family would want to include in their agreement (e.g. employment and remuneration of family members, education of next generation, etc.)

Section 3: Ownership Governance

» Bloodline only or including spouses
» The relationship between working and non-working owners
» The expected return on investment and dividend policy to be followed
» Decisions that could be reserved to owners and

how these same decisions are arrived at
- » The method of asset valuation to be used
- » How share transfers are executed between family members and branches

Section 4: Business Governance
- » Role of the Board
- » Composition of the Board
- » Role of non-executive directors
- » Communication between the Board and the Family
- » Remuneration and incentives
- » Decisions reserved to the Board

The constitution should clarify the relationship between the family and the business as well as each of the activities involved. If the family is ready to invest time and other assets in establishing and clearly defining the balance of power between the owners, the wider family and the company, there will be far less scope for the destructive conflicts that family business are unfortunately known to face with direct consequences known to all.

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The Maltese Family Business:

Getting Organised

EDITED BY MARIO DUCA

Family businesses, which have existed for centuries now, are rooted in the intergenerational family tradition of toiling land together to earn a living. Intrinsically, families need and want to take care and look after each other. Irrespective of the business sector that the family operates in, from farming to the latest high tech fields, they exhibit the same types of concerns for each other, namely family happiness and protection because "... we are of the same blood". Throughout the ages, families always sought advice from trusted elders or other special persons whom they trusted.

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