



## Business policies and agreements in a family business

The involvement of “family” in a business, results in some issues assuming a greater degree of complexity due to the emotional component.

Establishing policies concerning the business and how they feed into a governance framework is often done on an ad hoc basis. Prudent business owning families recognise that predictable issues are going to come up that will create some conflict or friction. They ask, how are we going to deal with this issue or that issue when it arises? They deal with this by establishing policies before the policies are actually needed. The advantages of this are:

1. Issues are attended to before they become personal and emotional and therefore are addressed more comfortably and rationally.
2. Expectations are managed for family involved inside and those outside the business and for non-family employed inside the business. Where policies are communicated effectively, there are no surprises.

Where policies are developed on this basis, they can be set in a much more objective fashion than where decisions are made in the middle of a crisis. Many of the conflicts that might otherwise arise are avoided by managing family members' expectations. While a family and business can never anticipate every policy needed, if they established policies in the past, this will have resulted in them previously reaching consensus through collaboration and, as a result, should be better equipped to deal with an unexpected issue.

When developing your family business policy guide, focus not only on the policies you need now – look ahead and anticipate what policies need to be put in place for the future.

The factors that influence policy development include:

- The stage and size of the business and size of the family.
- The culture of the business and family.
- The number of family members involved in the business who are shareholders.
- Harmony or lack of harmony in the family.

It is important to consider the following:

- Involve everyone who needs to be involved.
- Start with easier policies around code of conduct, philanthropy, employment (provided no one family member is joining the business in the near future), then moving on to issues around dividends, compensation policy for family members and finally issues around conflict of interest, governance including participation on the board of directors and shareholder agreement.

A good starting point is to look at policies that other families have adopted and leverage off that in deciding what is right for your business. It is also important that the policies be forward looking as opposed to being based on what has been done in the past.

Policies should not be a compromise of personal opinions but should emerge from values, beliefs and principles that the family believe should apply in operating their business. The core policies revolve around:

- Decision making/governance
- Compensation/performance evaluation
- Employment
- Codes of conduct

### Decision making/governance

- How are family decisions made? By consensus? By vote?
- Where voting, who is eligible to vote?
- How is stalemate resolved?
- What rights do family members have to be on the board of directors and will they be paid?
- What balance is there to be between family/non-family members?
- Who should chair the board and how are they selected?
- Are there criteria for family members serving on the board?
- Can family members not on the board contact independent/professional directors on their own?

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### Compensation/performance evaluation

This is one of the biggest areas of contention, often interacting with liquidity policies and distribution policies at shareholder level. Pay problems can arise due to role confusion, paying too little or too much, use of pay to smooth ups and downs, using pay to achieve tax savings and using pay to maintain parental control.

Key issues family should explore are:

- Market compensation or some alternative?
- Privacy or transparency on compensation of family members?
- Will compensation decisions be validated by outside consultants, independent board members, benchmarking?
- Expense accounts and perks?
- How is performance to be assessed relative to compensation?
- Who will determine those standards of performance?
- Who will perform the performance review and what rewards are there for exceptional performance?
- What penalties are there when performance does not meet expectations?
- How will these decisions affect non-family employees? Will they feel they are treated fairly?
- Will our policy be known to non-family employees? Will it motivate or de-motivate them?
- Do our compensation decisions make good business sense in driving a profitable successful business?

### Employment

- When will family members be permitted to work in the business? Qualifications/educational requirements/outside work experience?
- Will all be allowed join or only when positions are available and they are appropriately qualified?
- What process is there for hiring people, including family?
- Who makes the decisions? What criteria will be used? Will family members be favoured over non-family?
- Will in-laws be permitted to work in the business?

- Will only family who have the potential to rise to the top be permitted to join or can people join at lower levels, as long as they understand that is their role?
- What are the rules in respect of promotion?
- How is a family member's non-performance dealt with? What about full time versus part time employment? What about summer employment or part time jobs for younger family members?

#### Codes of conduct

- What rules will we establish as regards respect in dealing with each other?
- How will we handle conflict?
- Will we solve our problems behind closed doors and not in front of employees?
- How do we support each other? What information should we share with each other?
- What sort of communications policy should we have?
- What about confidentiality? How do we handle media relations?
- Should family members be allowed date employees? What about our lifestyles?
- What about contracts with other businesses owned by family members?
- What about personal use of business assets?

#### Documentation/agreements

When decided upon, many of these issues will need to be documented. Some may form the basis for an overall guiding statement of how the business should operate or a detailed document of protocol to be followed. On a more comprehensive basis, they may be documented as part of a family constitution and at a shareholder level, by way of a shareholder agreement. Many of the issues mentioned fall into the categories of business statement or business protocol or family constitution. At shareholder level, shareholder agreements would generally be concerned with the following:

- Who can own shares? Must the family members meet certain requirements to be owners?
- Should stock have different voting rights?
- Can in-laws or non-family employees own shares?
- In what circumstances can the company reacquire stock?
- How will buyouts be funded?
- When can stock be sold?
- Will the other owners/the company have the right of first refusal?
- How will the company be valued for any transactions in shares?
- What should the distribution policy be?

The possibilities for developing family business policies are potentially endless. Focus on those that are key to your business and family to facilitate clear communication on expectations and assist in resolving future potential sources of conflict.

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