A Guide to Family-run Firms

Business Information Factsheet
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Introduction

Family-run firms dominate the UK private sector and, in many aspects, they are just like any other business. However, there are some key differences and unique challenges, primarily due to the differing needs and demands of a family.

According to the Institute for Family Business, 65% of UK private sector enterprises are family firms, accounting for nearly 25% of GDP. A large majority are small firms, although there are estimated to be around 1,000 family firms in the UK with more than 250 employees.

This factsheet explains the main advantages and disadvantages family-run firms have compared with other firms. It outlines the key legal considerations affecting family-run firms.

What is a family-run business?

A family-run business is a firm that is controlled by a single family. The definition of a single family can be quite broad, particularly given the increasingly unconventional make-up of modern families. They can involve parents, children and grandchildren, spouses, partners and their relatives, and even close family friends. Family-run firms range in size from small 'father and son' enterprises to major UK corporations. For example, Associated British Foods, JCB and Clarks are all family-run firms.

Typically, for a business to be regarded as family-run, a single family owns a controlling stake in a private company of at least 50%. In many cases, the family owns the business outright.

However, ownership is not the only criterion for defining a family-run business. Usually, at least one family member will be directly involved in the management or administration of a family-run business. In some cases, a firm may be 100% owned by a single family, but the family may have little or no input in the day-to-day running of the business.

Legal considerations

All legislation affecting business, covering issues such as tax, trading and employment, applies to family-run firms. However, there are some specific additional considerations that apply to a family-run business, as follows.

Business structure

A family-run business can take many forms, such as a sole trader employing other family members, a partnership or a limited liability partnership between family members, or a limited company in which certain family members are directors. When setting up an enterprise as a family-run business, it is important to choose the structure that best suits the business and the people involved. A more formal structure may make it easier to keep domestic finances and other issues separate from those of the business.

Roles and responsibilities

It is also important to think about which family members will take on particular roles, and who will bear the legal responsibility for the business. In a small family-run business, it is common for all members to be registered as partners or directors in order to share legal responsibility. In addition, where younger family members are involved, proprietors should be aware of the law surrounding their involvement. The minimum age at which an individual can be registered as a partner or director is 16, and the minimum age at which an individual can sign a legally binding contract is 18 (16 in Scotland).

Family business constitution

It is advisable to draw up a family business constitution or charter. This formal document should include the aims and objectives, roles and responsibilities, and remuneration policy of the business. It should also set out how disputes will be resolved. This type of document can help prevent conflict arising, and can act as a practical guide to the running of the business. Drawing up the constitution should be a collaborative process involving all relevant family members, and legal advice should be sought to ensure the agreement is legally binding.

Employing family members

When employing family members, it is important to ensure they are paid correctly, and not below the legal limit or by 'cash in hand'. In most cases, family members aged 16 and over who work in the family business must be paid the national minimum wage (NMW). An exception applies to family members who live in the family home. However, this exception only applies to unincorporated family firms, and there may be some ambiguity where multiple family homes are involved. Family members who are company directors must be paid the NMW if they have an employment contract with the family firm.

Involving children

When involving young family members in the running of the business, certain restrictions apply. Children aged 13 and under cannot be employed, except in certain circumstances where a permit has been issued by the local authority in the area where the business is located. Children aged over 13 but under school leaving age can only be employed in accordance with limits on the number of hours they can work and other prohibitions set nationally and by local bylaws, such as restrictions relating to street trading. The NMW does not apply to employees aged 15 and under.

See BIF 259, A Guide to Employing Staff Under 18 Years Old, for further information.

What are the advantages of a family-run business?

The relationships at the heart of a family-run business can be its greatest strength. Shared values, objectives, commitment and pride can help give the business a competitive edge. A key advantage of a family-run business is that family members are likely to know each other very well, and be aware of each other's strengths, weaknesses, skills and knowledge. This can make setting out roles and responsibilities much easier than in a traditional business setting.

The family bond can create commitment and loyalty unique to a family-run firm. Family members will usually have pride in their business, and will do everything they can to make it a success. This may involve working extra hours, accepting lower pay, or generally 'going the extra mile'. A shared commitment to succeed and overcome obstacles can prove invaluable, particularly during difficult trading times.

Long-term stability is another advantage of a family-run business. Family members are often in it for the long term, with a view to building a succession plan for future generations.

Many family firms have worked hard to establish strong reputations and customer loyalty. This, combined with financial prudence, can make a family-run business well prepared to deal with economic downturns and difficult trading periods.

What are the disadvantages of a family-run business?

No family is the same as another, and as a result, no two family-run firms are the same. In some cases, the characteristics that bring advantages to family firms can also create disadvantages. Family relationships are often very different from professional relationships, and can create problems within the business and restrict its success. Sometimes, it can be hard to separate domestic life from the business, and family issues or difficulties, such as relationship breakdown and divorce, can cause conflict in the business environment.

Communication can be a problem in family-run firms, and this can lead to misunderstanding and conflict. In some cases, because they have a close personal relationship, family members may assume they know what other members want or are thinking. Some family members may not express their opinions about the business for fear of damaging family relationships. A failure to communicate properly can lead to conflict and can hinder or harm the business.

Employing family members can bring its own problems. In some cases, a family member may not be the best candidate for the role they are given. They may not have the knowledge or skills to carry out the role satisfactorily, but may be given the job out of family loyalty. In other cases, family members can regard a job within the family firm as a job for life.

If a firm employs non-family members alongside family members, they must achieve a careful balance. If non-family members feel that family members are better treated or paid, or have undue influence or advantage, it can be divisive, cause problems within the business, and may lead to claims of discrimination.

Family-run firms may risk becoming set in their ways and resistant to change. The business may have been built up by previous generations, and family members may be reluctant to change something that has worked for a long period of time. New ideas can be rejected without fair consideration, and the business can fall behind the times as a result. Change is inevitable as trading conditions, trends and technologies evolve, and family-run firms need to be geared up to accept and manage change.

On a personal level, running a family business can mean that the whole family is reliant on a single source of income. If the business struggles or fails, this could have a devastating financial effect on the family. In some cases, it may be difficult to draw a distinction between domestic life and business, for example conducting business meetings around the dinner table.

Succession and generational issues

According to the Institute for Family Business, only around a third of family-run firms are passed on to the second generation of the family, with the other two thirds being sold or closed down. Succession or generational transfer can be the most life-threatening stage of a family-run business, and it is important to have plans in place for when it occurs. It is not sufficient merely to identify and name the successor or successors. Proprietors also need to ensure successors are properly trained in how to run the business successfully. A gradual handover of control is the best way to achieve this.

Owners of family firms are traditionally succeeded by their children. In some cases, there will be obvious candidates. However, in others, identifying the successor or successors may be problematic, and the child might not always be the best option for the business. In these cases, a non-family member or outsider may be better suited.

If proprietors plan to hand down the business to the next generation, they may need to choose between their children. Another important consideration is whether the family would benefit more if the business was sold rather than handed down. In each case, the proprietor should try to place the needs of the business, and the family as a whole, ahead of sentimentality.

It is important to consider the tax implications of succession and generational change. Capital gains tax or inheritance tax may be incurred on the transfer or sale of a business. Professional advice about potential tax liability should be sought, depending on individual circumstances, because rules and tax relief change frequently. Go to www.gov.uk/capital-gains-tax-businesses for further information.

Divorce issues

When a married couple are in a family business together, various decisions need to be made in the event of divorce.

The impact of the relationship breakdown on the family firm will need to be carefully managed. It will affect the everyday working relationships of everyone working in the business, and it may have consequences for the future of the business.

Often, the family business will be treated as a source of income, but in some cases, the business may need to be restructured, or even sold, in order to meet the terms of a divorce settlement.

Where required, a court will assess the value of a family business and determine how that value should affect the settlement. The value of the business is treated as an asset when determining the divorce settlement. In some cases, it will be possible to fund the settlement via liquid assets, such as bank balances, although consideration will be made as to how that would affect the firm's prospects. In other cases, restructuring, sale of shares, or sale of the entire business may be required in order to fund the divorce settlement. This is a complex issue, and it is essential to seek professional advice.

Hints and tips

Proprietors should:

- Create an atmosphere for open communication between family members involved in the business.

- Recognise and appreciate that change can be necessary and beneficial.
- Embrace outside influences and avoid the business becoming insular.
- Employ family members in roles for which they have suitable skills and knowledge.
- Consider recruiting non-family members in order to benefit from their new ideas, skills and perspective.
- Plan early for exit or retirement to enable a gradual and successful handover or succession.

Further information

BIF 32 Choosing the Right Business Legal Structure
BIF 150 An Introduction to Selling Your Business
BIF 259 A Guide to Employing Staff Under 18 Years Old
BIF 283 Methods of Valuing a Business

Books

'Keeping the Family Business Healthy: How to Plan for Continuing Growth, Profitability, and Family Leadership'
John L. Ward
2011
Palgrave Macmillan

Useful contacts

The Institute for Family Business is a non-profit membership organisation representing and supporting UK family firms. It provides networking opportunities and information and guidance to members.
Tel: (020) 7630 6250
Website: www.ifb.org.uk

The Scottish Family Business Association provides information and training for family-run firms in Scotland.
Website: www.sfba.co.uk

Campden FB is a magazine and website providing news and features about family-run firms.
Website: www.campdenfb.com

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