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Continuity Planning for Family-Owned Businesses

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Summary

The overriding objective of any business family when undertaking succession planning is to ensure the smooth transition of wealth from one generation to the next, while maintaining family harmony and ensuring that the business survives the transition unscathed. The traditional approach of business succession and wealth transition planning, which focusses on a one time transactional process of transferring financial assets from one generation to the next in a tax efficient manner, often gets the timing and order of work wrong. Continuity planning is a long term, multidisciplinary process which starts with the human elements of the family.

Researchers have identified the following four main causes of wealth transfer failures:

1. Lack of family mission and vision: 10%;
2. Breakdown of trust and communication within the family: 60% ;
3. Failure to prepare heirs for roles and responsibilities: 25%; and
4. Professional errors in accounting, legal or financial advisory planning: less than 5%.[1]

Of note, less than 5% of succession plans that failed, failed due to professional negligence. Commonly implemented succession and wealth transition structures, which are primarily put in place to minimize or defer taxes and manage risk, result in a failed succession plan, not because of the structures themselves, but in spite of them. The technical skills of wealth transfer are certainly important and should in no way be diminished. That said, proficient legal and tax planning does not ensure a successful transition of wealth. Traditional succession planning only prepares the assets for the family. Continuity planning prepares the family for the assets.

What follows is an overview of:

1. The nature of family business;
2. The main theoretical concepts of family business;
3. The unique importance of succession for family business;
4. The concept of transgenerational wealth; and
5. Continuity planning, its process and management.

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[1] Roy Williams & Vic Preisser, *Preparing Heirs: Five Steps to a Successful Transition of Family Wealth and Values*, 1 edition ed (San Francisco, Calif: Robert Reed Publishers, 2010).

Table of Contents

I. The Nature of Family Business

1. Prevalence of Family Business

Advising family businesses is a robust and vibrant practice area – with good reason. Family businesses are ubiquitous. About half of the Canadian workforce is employed by a family enterprise. Canadian family enterprises are estimated to create anywhere from 45 to 60 percent of Canadian GDP, and family enterprises create an estimated 70 to 90 percent of global GDP annually.[2] Recent research suggests that the actual number of family controlled enterprises in the world may constitute 80 percent of all businesses. That said, there are discrepancies between sources, largely because there is a lack of consensus on what is meant by family, let alone what is meant by the term family business.[3]

2. Definition of Family Business

Although there is no common definition of what constitutes a family business, family businesses generally have the following characteristics:

1. Multiple members of the same family are involved as major owners or managers, either contemporaneously or over time;[4]

2. The family controls the business through involvement in ownership and management positions;[5]

3. The family has intergenerational intent;[6] and

4. The business contributes significantly to the family's wealth, income and/or identity.[7]

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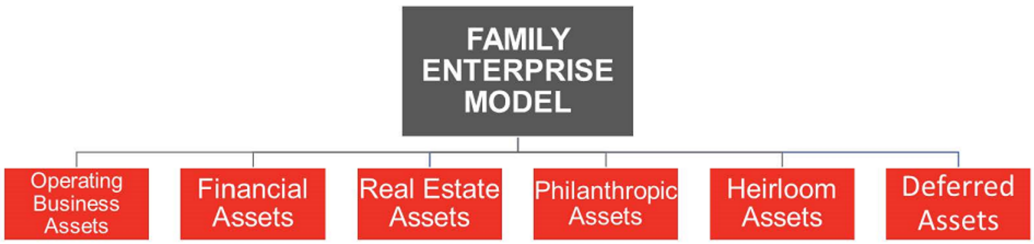
[2] Jennifer Halyk, *Research Matters in the Family Enterprise Field: Where Theory and Practise Meet* (Sauder School of Business Business Families Centre, 2012).
[3] Joseph H Astrachan, Sabine B Klein & Kosmas X Smyrnios, "The F-PEC Scale of Family Influence: A Proposal for Solving the Family Business Definition Problem1" (2002) 15:1 Family Business Review 45.
[4] Danny Miller et al, "Are family firms really superior performers?" (2007) 13:5 Journal of Corporate Finance 829 at 836.
[5] Inc The Family Firm Institute, *Family Enterprise: Understanding Families in Business and Families of Wealth, + Online Assessment Tool*, har/psc edition ed (Hoboken, New Jersey: Wiley, 2013) at 2.
[6] Jon C Carr & Jennifer M Sequeira, "Prior family business exposure as intergenerational influence and entrepreneurial intent: A Theory of Planned Behavior approach" (2007) 60:10 Journal of Business Research 1090.
[7] Amy M Schuman, Wendy Sage-Hayward & David Ransburg, *Human Resources in the Family Business: Maximizing the Power of Your People*, 1st ed. 2016 edition ed (Basingstoke, Hampshire : New York, NY: Palgrave Macmillan, 2015).

3. Definition of Family Enterprise

Whereas the concept of a family business often implies a singular business unit such as a store, office or factory, a family enterprise often refers to a portfolio of businesses or initiatives that a family may be involved in. These initiatives include not only one or more operating business units, but also can include portfolios of other assets to be managed and shared, including financial, real estate, philanthropic, heirloom and deferred assets:[8]



[9]

In fact, family enterprises are the norm as 89.4% of families control more than a single firm, with the mean number of firms controlled by a family at 3.4.[10]

4. Complexity of Family Business

The complexity of family enterprises arises from trying to balance family demands and the needs of the business, while at the same time addressing the complex interaction between the two. As well as dealing with commonplace business issues, such as changes in business and technological markets and challenges from competitors, family businesses must deal with the unique psychological dimensions of having family members work together.

Each of the family members in the business will have their own objectives, perspectives and goals. Working together intensifies family interactions and can exacerbate family problems such as sibling rivalry or competition between the generations. Unresolved conflicts and diminishing communication and trust can undermine the operation of the business and ultimately result in a detrimental effect on the business.

Key issues to be tackled include effective decision-making across the family, management and ownership arenas, conflict resolution, facilitating effective ownership of the business, balancing the involvement and performance management of family members with their skill set and those required by the business, while above all operating in the best interests of the business and family as a whole.

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[8] Deferred assets are assets that do not come into play until after death, like insurance and annuities.
[9] *Family Enterprise Model* (Family Enterprise Xchange, 2018).
[10] Mattias Nordqvist & Thomas Zellweger, "Transgenerational Entrepreneurship: Exploring Growth and Performance in Family Firms Across Generations" (2010) http://www.alexandria.unisg.ch/Publikationen/54561.

5. Performance of Family Businesses

Research has demonstrated that family firms are top performers. While family businesses certainly confront many challenges, they also possess advantages born out of a unique and dynamic owner-manager-family interaction. Whether measured by the bottom line, value creation for shareholders or their capacity to create jobs, family companies often outperform their non-family counterparts.[11] A Thomson Financial study for Newsweek compared family firms to rivals on the six major indexes in Europe and showed that family companies outperformed their rivals on all of these indexes, from London's FTSE to Madrid's IBEX..[12] Authors have argued that family businesses often outperform non-family firms due to their long term outlook and lack of pressure from shareholders driven by short term financial goals.[13]

The term "familiness" has been developed and widely accepted to describe the unique bundle of resources, available for establishing a strategic advantage, held by and particular to family firms as a result of their unique systems, interaction among the family, individual members and the business itself. It may be that these "familiness qualities," including, but not limited to, strategic focus, customer orientation, family relationships, and operational efficiency, contribute to the superior performance of family versus non-family firms.[14]

6. Social Responsibility, Philanthropy and the Family Business

Research has shown that family firms are often more socially responsible than non-family firms along several dimensions. In fact, the majority of research on this subject suggests that family enterprises tend to exhibit higher levels of corporate social responsibility and greater citizenship in the community than non-family firms.[15] Researchers theorize that this is likely due to family concern about image and reputation and a desire to protect family assets.[16]

[11] Ernesto J Poza, *Family Business*, 3 edition ed (Mason, Ohio: South-Western College Pub, 2009) at vii.
[12] IFC International Finance Corporation, *IFC Family Business Governance Handbook* (World Bank Group) at 12.
[13] Doug Baumoel & Blair Trippe, *Deconstructing Conflict: Understanding Family Business, Shared Wealth and Power*, first edition ed (Continuity Media, 2016) at 6.
[14] John Tokarczyk et al, "A Resource-Based View and Market Orientation Theory Examination of the Role of 'Familiness' in Family Business Success" (2007) 20:1 Family Business Review 17.
[15] Pascual Berrone et al, "Socioemotional Wealth and Corporate Responses to Institutional Pressures: Do Family-Controlled Firms Pollute Less?" 32.
[16] W Gibb Dyer & David A Whetten, "Family Firms and Social Responsibility: Preliminary Evidence from the S&P 500" (2006) 30:6 Entrepreneurship Theory and Practice 785.

7. Current State of Family Business Research

Family business research is the study of family-owned and managed businesses, and their subsystems that affect the way they operate. The interest in family firm research has grown significantly in recent years, leading to an emerging field of study within business research. The underlying assumption of this research field is that family firms have particular characteristics that distinguish them from non-family firms. Despite the progress made in the identification of these differences, especially in the last decade, research on family firms remains a new field which is still building legitimacy within management studies.[17]

II. The Main Theoretical Concepts of Family Business

1. Systems Theory

Systems theory is the theoretical approach most often used in the scholarly study of family business. A system is a network of interdependent components that work together to try to accomplish the aim of the system.[18] Five principles of systems thinking that impact on family businesses are as follows:

1. The whole is greater than the sum of its parts;
2. Organizations seek homeostasis: trying to keep things stable or the same;
3. Patterns of behaviour are predictable over generations;
4. Every action creates a non-linear reaction, like a ripple in a pond; and
5. Interfacing life cycles imply constant changes.[19]

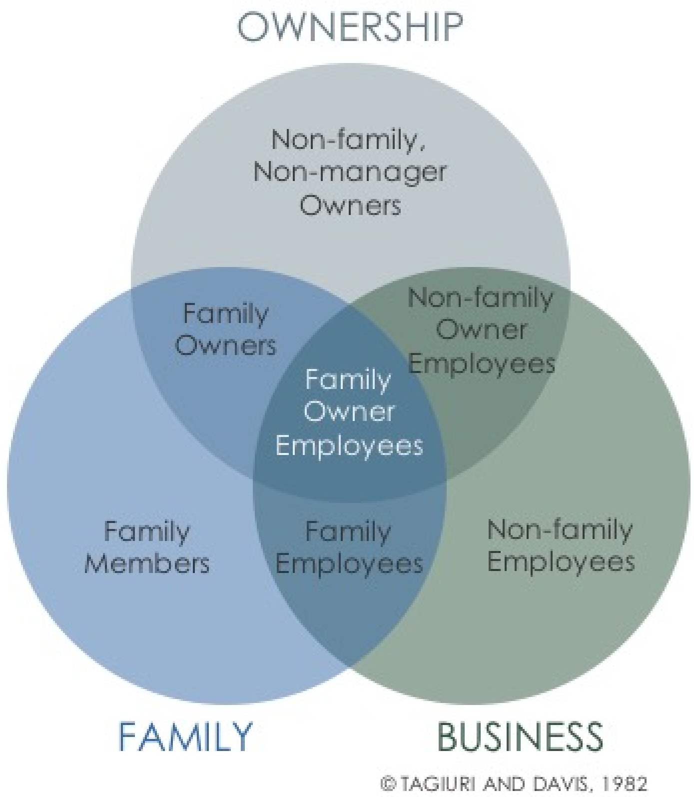
(a) The Three Circle Model

In the systems theory approach, the family firm is modeled as comprising three overlapping, interacting and interdependent subsystems of family, ownership and management.[20]

[17] Sascha Kraus, Rainer Harms & Matthias Fink, "Family Firm Research: Sketching a Research Field" (2011) 13 Int J of Entrepreneurship and Innovation Management 32.
[18] William Edwards Deming, *The New Economics: For Industry, Government, Education* (MIT Press, 2000) at 50.
[19] Family Enterprise Exchange, *Business Family Dynamics* (2018) at 14.
[20] Renato Tagiuri & John Davis, "Bivalent Attributes of the Family Firm" (1996) 9:2 Family Business Review 199.

THREE-CIRCLE MODEL

OF THE FAMILY BUSINESS SYSTEM



Each subsystem maintains boundaries that separate it from the other subsystems and the general external environment within which the family business operates. This model suggests that a family firm is best understood and studied as a complex and dynamic system in which each of the subsystems has a strong impact on the other subsystems and accordingly the larger system as a whole.

If a person has one role, they will be in just one subsystem or circle. However, if they have more roles, they will be in an overlapping sector, sitting within two or three circles at one time. Within the three circle model, there are seven distinct groups with a connection to the family business:

1. Family members not involved in the business, but who are descendants or spouses/partners of owners;

2. Family owners not employed in the business;

3. Non-family owners who do not work in the business;

4. Non-family owners who work in the business;

5. Non-family employees;

6. Family members who work in the business but are not owners; and

7. Family owners who work in the business.

Each of the seven interest groups identified by the model has its own viewpoints, goals, concerns and dynamics. The long-term success of family business system depends on the functioning and mutual support of each of these groups.

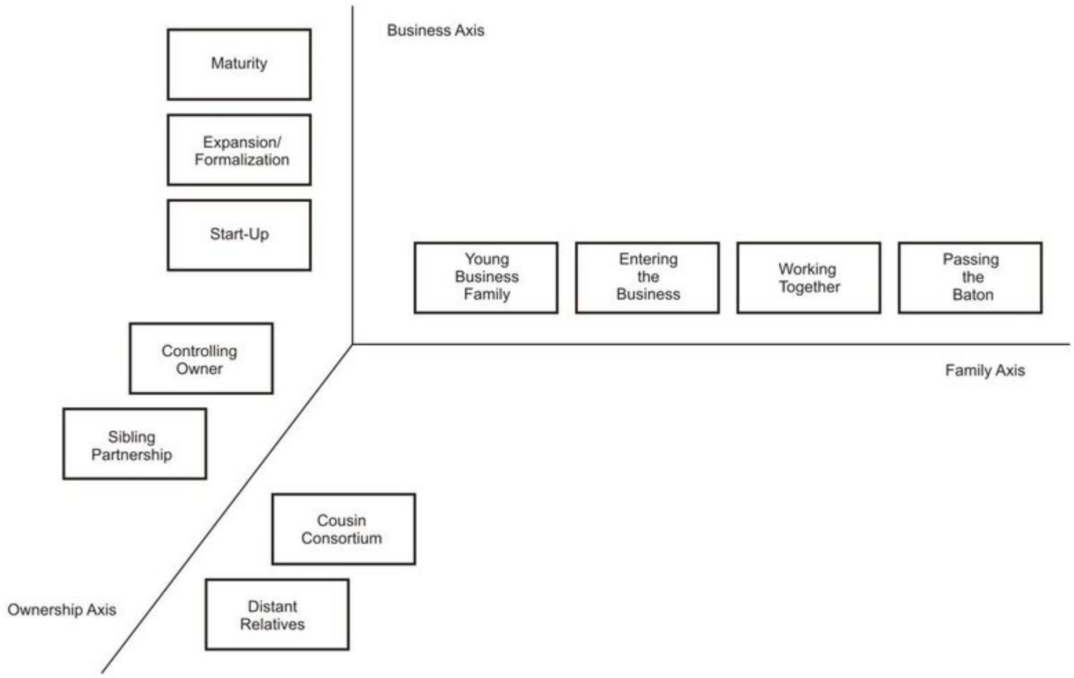
2. Developmental Models

Whereas the three circle model (business, ownership, and family) helps to assess a family business at a certain point of time, a developmental approach helps to identify dilemmas and problems that arise due to changes within the business, the family and the distribution of ownership over time.[21]

(a) The Three Dimensional Developmental Model

In each of the three subsystems – ownership, family and business – there is a separate developmental dimension. The ownership subsystem goes through its sequence of stages, the family subsystem has its own sequence and the business also progresses through a sequence of stages. These developmental progressions influence each other, but they are also independent. Each part changes at its own pace and according to its own sequence. As the family business moves to a new stage in any of the dimensions, it takes on a new shape, with new characteristics.[22]

[21] John A Davis et al, *Generation to Generation: Life Cycles of the Family Business*, Kelin E. Gersick, ed. (Harvard Business Review Press, 1997) at 15.
[22] *Ibid* at 18.



[23]

The family axis of the developmental model was influenced by the psychologists Erik Erikson and Daniel Levinson and their stages of life theories.[24] The ownership axis is derived from the work John Ward on how successive stages of family ownership result in fundamental differences in every aspect of the family business.[25] The business axis is a merger of numerous business life-cycle models. The overall model provides a framework for understanding family businesses over time in each dimension, and suggests how a recognition of the current stage, and the interaction of the various stages across the ownership, family and business subsystems, could help with the analysis of the dynamics of the family business.

(b) The Interfacing Life Cycles Model

The interfacing life cycles model builds on the developmental model by adding two more axes: industry and individual.[26]

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[23] *Ibid* at 17.

[24] Martin Gerstein & Michele Papen-Daniel, *Understanding Adulthood. A Review and Analysis of the Works of Three Leading Authorities on the Stages and Crises in Adult Development. California Personnel and Guidance Association Monograph Number 15* (California Personnel and Guidance Association, 654 East Commonwealth Ave, 1981).

[25] *Keeping the Family Business Healthy - How to Plan for Continuing Growth, Profitability, and Family Leadership | J. Ward | Palgrave Macmillan*.

[26] Kets de Vries et al, *Family business on the couch. A psychological perspective.* (Chichester: John Wiley & Sons, 2007).

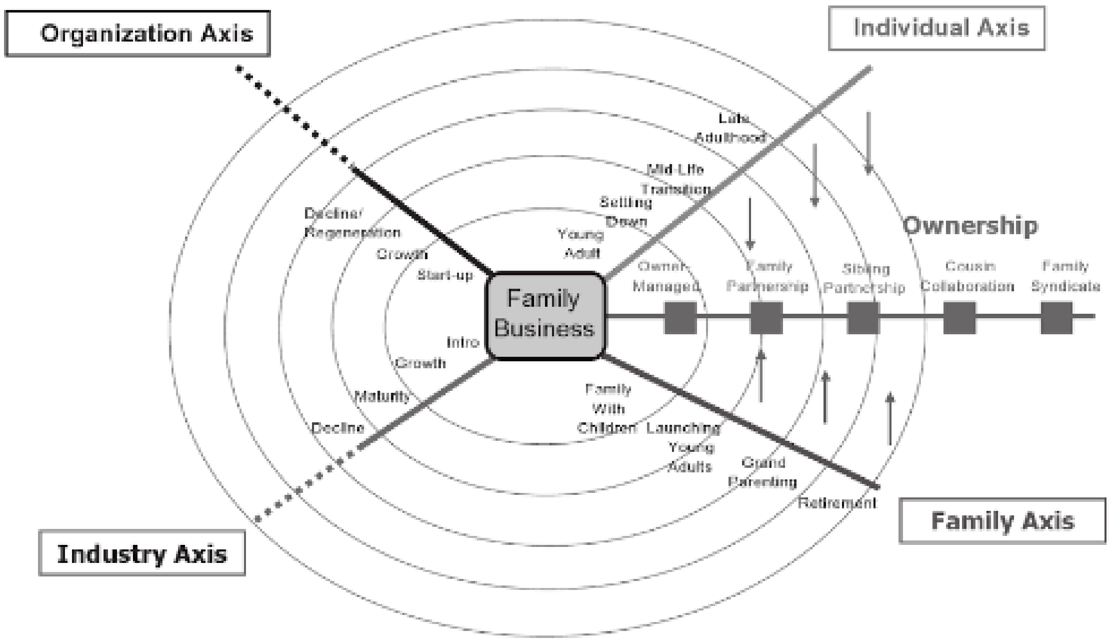

Figure 4.1 Life cycle forces impacting on strategy, structure, management and ownership in family businesses [2]

The model is based on the assumption that the most intractable family business issues are not the business problems the organisation faces, but the psychological and emotional issues that compound them. Applying the model is intended to help to explain behaviour and enable the family to prepare for life cycle transitions and other issues that may arise in the family business.

III. The Unique Importance of Succession for the Family Business

Family businesses are unique in the extent to which succession planning assumes a key role in the firm's life. Because business competitive success, family harmony and ownership returns are all at stake at the same time in the firm, carefully orchestrating the multi-year succession process across generations of owner-managers is a priority. In family owned companies, the most common reason they fail is related a failure in succession planning.

Regularly quoted succession statistics of family businesses are grim. John Ward's seminal study in 1987 found that only 30 percent of family businesses are successfully transferred to the next generation from the founding family owners. And the odds get worse in the transitions between the second and third generations and the third and fourth generations, when only 13 percent and 3 percent of such businesses remain in the founding family.[27]

These often repeated succession statistics seem to prove true the old adage "from shirtsleeves to shirtsleeves in three generations." The phrase encapsulates the theory that the first generation of an enterprising family spends its lifetime working hard and living frugally, the second generation enjoys a comfortable lifestyle, eventually entering elite society, and the third generation grows up in luxury, doing little or no work while squandering the family fortune.

IV. Updated Concepts of Intergenerational Wealth

John Ward's 30/13/3 statistic has been largely unchallenged in mainstream literature and media coverage of family-owned businesses. It seems to suggest that there is something fundamentally "wrong" with family firms, and that they inevitably fall into the three-generation survival trap. Even though the survival rates of non-family firms are by no means larger, family business research has contributed to a rather negative outlook of family business succession in particular. Existing family firm survival studies often neglect the portfolio of entrepreneurial activities of business families beyond a core company. Further, most traditional longevity studies fail to acknowledge other forms of succession beyond passing on the business within the family, such as the sale of the firm as way to harvest value and create new opportunities for the family.[28]

1. Concept of Transgenerational Wealth

The concept of family-influenced, transgenerational wealth creation re-frames succession by focussing on developing a family's entrepreneurial tendencies. With transgenerational wealth creation as a goal, the survival of one family firm - a single operating business - is not the only way to pursue and achieve long-term success, and low succession rates do not mean that a family enterprise is inept or incapable.[29]

Transgenerational wealth creation allows the next generation to use the family resources to take risks and build an entrepreneurial orientation. Proactive, entrepreneurial strategies such as diversifying assets through a sale or strategic alliances should not mean that family businesses are considered failures. To grow a family's wealth and pass it on to subsequent generations for their stewardship, the next generation should be given the

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[27] John L Ward, "The Special Role of Strategic Planning for Family Businesses": (2016) Family Business Review, online: <https://journals.sagepub.com/doi/pdf/10.1111/j.1741-6248.1988.00105.x>.

[28] Thomas Markus Zellweger, Robert S Nason & Mattias Nordqvist, "From Longevity of Firms to Transgenerational Entrepreneurship of Families: Introducing Family Entrepreneurial Orientation" (2012) 25:2 Family Business Review 136 at 2.

[29] Zellweger, Nason & Nordqvist, *supra* note 29.

opportunity to take risks and pursue new directions that are essential for multi-generational growth.

Succession should only be considered to have failed if the next generation involuntarily loses control of the transitioned assets. Specifically, if a family business is sold and the financial assets are voluntarily redeployed into the financial markets, this is considered a restructuring of those assets, not a failed succession plan. Similarly, if the transitioned financial assets are used for philanthropic purposes, that is considered a voluntary redistribution of those assets. Involuntary losses or succession failure occurs only when beneficiaries lose control of their wealth through factors such as "foolish expenditures, bad investments, mismanagement, inattention, incompetence, family feuding, or other causes within their control."[30]

2. Concept of Complete Wealth

Adding to the understanding that successful intergenerational wealth transfer may or may not involve the transfer of an operating business to the next generation, wealth itself can be understood as more than pure financial assets. A conception of a family's "complete wealth" is that, in addition to quantitative, financial capital, it also includes qualitative components, including human, intellectual, social and spiritual capital.[31] The family's financial capital is a tool to support the growth of its human, intellectual, social and spiritual capitals. The key concept of complete wealth is that the most important assets of a family are in fact its individual members.[32]

(a) Human Capital

The human capital of a family consists of the individuals who make up the family. Their human capital includes their physical and emotional well-being as well as each member's ability to find meaningful work and establish a positive sense of identity.[33] When speaking about human capital, it includes effective parenting and grand-parenting, communication, consensus building, team building, conflict resolution, leadership training, values, morals and ethics and goal setting.[34]

(b) Intellectual Capital

The intellectual capital of a family is composed of the knowledge gained through the life experiences of each family member and what each family member knows. Intellectual

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[30] Williams & Preisser, *supra* note 1 at 16.
[31] James E Hughes Jr, Susan E Massenzio & Keith Whitaker, *Complete Family Wealth*, 1 edition ed (Hoboken, New Jersey: Bloomberg Press, 2017) at 9.
[32] *Ibid* at 36.
[33] *Ibid* at 11.
[34] Lee Hausner & Douglas K K Freeman, *The Legacy Family: The Definitive Guide to Creating a Successful Multigenerational Family*, 2010 edition ed (New York: Palgrave Macmillan, 2009) at 7.

capital includes family members' academic successes, career growth, artistic achievements, financial literacy and the ability to learn and teach what they know.[35]

(c) Social Capital

Social capital refers to family members' relationships with each other and the larger community. It also refers to the family's ability to share and sustain an intention that transcends each member's individual interests, often in the form of volunteer and philanthropic activities.[36]

(d) Financial Capital

Financial capital of a family is the property it owns. It comprises all branches of the family enterprise, including operating business assets, financial assets (cash, public securities, privately held company stock, interests in private partnerships), real estate assets, philanthropic assets, heirloom assets and deferred assets. Financial capital is the tool that that facilitates the cultivation of the other forms of capital.[37]

V. Continuity Planning

1. Definition of Continuity Planning

The traditional approach of succession and wealth transition planning, which focusses on a one time transactional process of transferring financial assets from one generation to the next in a tax efficient manner, often gets the timing and order of work wrong. Successful continuity planning is a long term, multidisciplinary process which starts with the human elements of the family.

2. Why Continuity Planning

A study of 3,250 families over twenty years found the following four main causes of wealth transfer failures:

1. Lack of family mission and vision: 10%;
2. Breakdown of trust and communication within the family: 60% ;
3. Failure to prepare heirs for roles and responsibilities: 25%; and

[35] Jr, Massenzio & Whitaker, *supra* note 33 at 11.
[36] Hausner & Freeman, *supra* note 36 at 7.
[37] Jr, Massenzio & Whitaker, *supra* note 33 at 12.

4. Professional errors in accounting, legal or financial advisory planning: less than 5%.[38]

Of note, less than 5% of succession plans failed due to professional negligence. The commonly implemented succession and wealth transition structures, which are mostly established to minimize or defer taxes and manage risk, result in a failed succession plan, not because of the structures themselves, but in spite of them.[39] The backbone of continuity planning is for advisors to work together over time in multi-disciplinary teams in order to address both "soft" and "hard" issues to truly help business family clients. The technical skills of wealth transfer are certainly important and should in no way be diminished. That said, proficient legal and tax planning does not ensure a successful transition of wealth. Rather, it is how well the family is prepared to deal with the transition of wealth that is much more important.

3. The Continuity Planning Process

The overriding objective of any family when undertaking continuity planning is to ensure the smooth transition of wealth from one generation to the next while maintaining family harmony and ensuring that the business survives the transition unscathed. A continuity plan is far more likely to be successful if it is borne out of early preparation and the coordination of the three circles: family, ownership and business. Continuity planning requires the setting of clear objectives, agreement within and between the three circles, good communication, appropriate governance structures, recognition of risks and timely action.[40] The lack of effective governance is a major cause of continuity problems and is thus a critical first step in starting the continuity planning process.

(a) Governance Planning

At its most basic level, governance is an organizational structure which helps groups make decisions. A governance system is a combination of governance structures, processes, plans, statements, policies, rules and agreements used to pursue the governance objectives of an organization.[41] The governance of a family business is more complicated than for non-family owned companies because of the central role of the family that owns and typically leads the business. In a family business, the business, the family, and the ownership subsystems all need governance.

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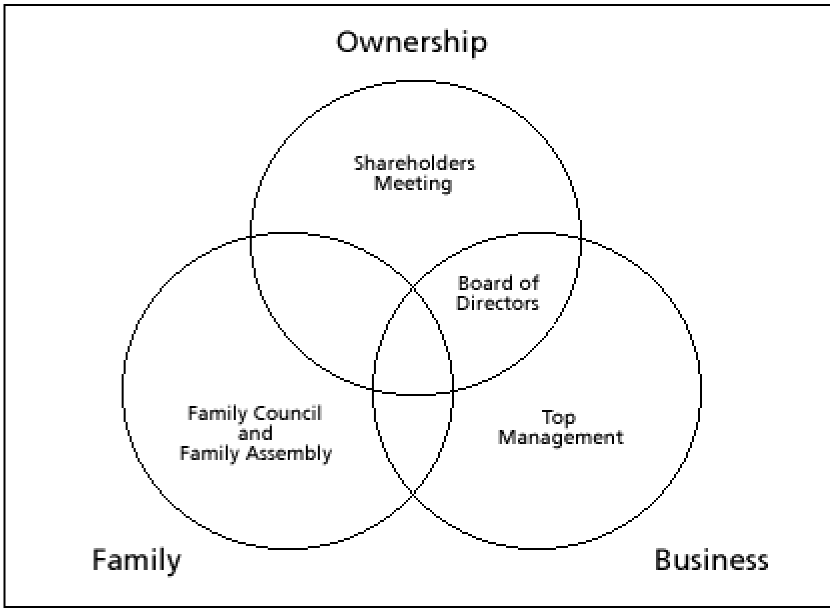
[38] Williams & Preisser, *supra* note 1 at 36.

[39] Emily Griffiths-Hamilton, *Build Your Family Bank: A Winning Vision for Multigenerational Wealth* (Vancouver: Figure 1 Publishing, 2014) at 19.

[40] Simon Rylatt, *Business Families and Family Businesses: The STEP Handbook for Advisers*, 2nd edition ed (Woking, Surrey, United Kingdom: Globe Law And Business, 2018) at 132.

[41] Drew S Medoza & John L Ward, *Family Business Governance: Maximizing Family and Business Potential*, 2011 edition ed (New York: Palgrave Macmillan, 2010).

Governance in a family enterprise can refer to the overall governance of the family business system, or it can refer to any of the specific types of governance found in each of the three subsystems in a family business system:



[42]

(i) The Role of Governance in the Family Business System

As a family moves from unilateral decision making in the owner-founder stage towards more complex decision making in the siblings and then cousins consortium stage, increased and more formalized governance is important to ensure that the right people are given the right information to make the right decisions. The three systems of governance do not necessarily need to be in place all at once, nor do they necessarily need to operate simultaneously in one family enterprise. The type of governance structure that a family firm needs at any one point will depend on the developmental life stage of the business: inception, growth, harvest; and the stage of family ownership: owner-founder, sibling partnership, cousin consortium.[43] One type of governance structure does not fit all family enterprise systems, but most family enterprise systems can be governed by a few structures set out below.

(ii) Family Circle Governance

The governance needs of family businesses will depend on various factors, some quantitative such as family size, business complexity and the balance between insiders and outsiders. Other factors will be qualitative, including the degree of cohesion and quality of

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[42] "Governing the Family-Run Business", (4 September 2001), online: *HBS Working Knowledge* <http://hbswk.hbs.edu/item/governing-the-family-run-business>.

[43] Fred Neubauer & Alden G Lank, *The Family Business: Its Governance for Sustainability* (New York: Routledge, 1998).

communication between family members. Smaller and/or more cohesive families may start with frequent family meetings . Families facing greater tensions or complexity many need a more formalized approach at the outset, including the negotiation of family charters and shareholder's agreements.

(1) Family Assembly

Also called family meetings, family forums, family briefings, family gatherings, family retreats or family conventions, a family assembly is a meeting of the wider business family. Attendance is usually open to all adult family members, irrespective of whether they work in or hold shares in the business.

Family meetings are essential in any family enterprise and are the most effective forum for averting the primary causes of failed family wealth transitions. As family members participate in creating the family's shared future through family meetings, these meetings become a place to strengthen trust and communication, to prepare the upcoming generation for their future roles and responsibilities and to reinforce shared values and develop a shared vision.

(2) Family Council

A family council is an advisory and consultative body which represents the business owning family. The key role of the family council is to facilitate communication between the family members and the board of directors. The family council will also usually organize family assembly meetings.

(3) Family Charter

Also called the family constitution, family creed, family protocol or family agreement, the family charter is the main document where the family sets out their values, vision and commitment in relation to the family business. It is also used to record the agreement the family have reached on key issues such as who can own shares in or work for the family business. Family charters are rarely binding legal documents and instead record agreements in principle and the aspirations of the business owning family.

Families who are able to define and articulate their shared goals, and the guiding values and principles that will help achieve them, give their businesses a strong foundation for sustainability and successful succession. A family business can be seen as the external manifestation of a family's value system. Values, or rules for living, underpin a code of behaviour that builds and supports family vision and business mission, and they inform the family's decision making. During periods of challenge and transition, a family business is supported by a belief in shared values, but where there is no clear vision to unify a family, opportunities for conflict can arise.[44]

Codifying values increases in importance with the passage of time. As families expand and scatter geographically and culturally, a sense of shared values, updated and revitalized with each generation, becomes increasingly important in binding families together and to the business. The family communicates its vision and values to the board, which sets strategies and implements actions accordingly. With shared vision and common values inspiring business performance, a virtuous circle can be created. When family members see their values strengthening the business, then their pride in those values and the family is reinforced.[45]

(iii) Ownership Circle Governance

The ownership subsystem comprises the actual equity owners of the family enterprise. Business ownership can be seen as a package of rights and responsibilities. Arguably , the chief responsibility of business owners is to provide capital to the firm. In most jurisdictions, in exchange for capital, shareholders are given rights, such as to attend and vote at shareholder meetings, to receive dividends and to elect the board of directors, which has the primary responsibility of managing the business.

Ownership in family businesses tends to progress through a sequence of continuity:

1. Owner-managed businesses in which ownership of the company is in the hands of just one person;

2. Sibling partnerships where ownership has been divided more or less equally among a group of siblings, some or all of whom work in the business; and

3. Cousin companies (third generation firms and older) in which ownership has been spread across a group of shareholders, a significant proportion of whom take no part in the day-to-day management of the business[46].

Added to the incremental stages of ownership of a family enterprise, are six types of owners:

1. An operating owner with direct responsibility for running the business;

2. A governing owner who is a full time overseer but not involved in the family business, such as a chairman of the board of directors;

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[44] Peter Leach & Victoria B Mars, *Family Enterprises: The Essentials*, main edition ed (Profile Books, 2016) at 5.
[45] *Ibid*.
[46] Davis et al, *supra* note 21.

3. An involved owner who is not employed in the business but takes a genuine interest in the company, offering support to management as appropriate;

4. A passive owner who collects dividends but abdicates responsibility for the business to others and makes no conscious decision to stay an owner;

5. An investor owner who is similar to a passive owner except if they are dissatisfied with their returns, they may make a deliberate decision to keep or sell their ownership; and

6. A proud owner who is not engaged in the business or especially knowledgeable about it, but nonetheless is proud to be an owner.[47]

(1) Shareholders Assembly/Owner's Council

The governance structure for the ownership subsystem is an owner's council or shareholders assembly, which consists of representatives elected by the group of owners. This council is the foundation of the governance system for the business. The ownership council has the ultimate authority to choose members of a board of directors or a board of advisors, as well as the chairperson of a board. If the business is still in the inception or owner-founder stage, an ownership council could even include family members who are not technically "owners" but would prevent decision-making to be concentrated onto a single owner-founder.

The ownership council addresses anything related to ownership of the company: decisions on behalf of all shareholders, liquidity issues, generational, continuity and transition issues, and how to execute the family's long-term vision. Shareholders meetings, including all shareholders, are held as a method of communication between the council and the larger ownership group.

(iv) Business Circle Governance

There is a clear link between family business governance and continuity planning. The key question in any continuity planning exercise is whether the next generation are ready to assume a high level or full management responsibility in the business. The reverse side of this question is whether, in reality, the current generation are ready to let go of responsibility for the direction and control over the family business. Failure to address these issues often means that real decision making resides in the hands of the first generation founder-owner, with the remaining family members holding nominal positions and playing supporting roles.

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[47] C Aronoff & J Ward, *Family Business Ownership: How to Be an Effective Shareholder*, 2nd ed. 2011 edition ed (New York: Palgrave Macmillan, 2011).

(1) Board of Advisors

The board of directors, a legal requirement in most jurisdictions, is the primary governance structure for any family business. During a family business' early stages the board is foremost a statutorily required legal entity and often a "rubber stamp" board for the owner-operator. It often transitions over time into an advisory board, comprised of trusted employees, professional advisors, such as the lawyer and accountant, and friends. The function of an advisory board is to provide a sounding board for the founder's ideas and concerns over the direction of the business. Usually an advisory board is an interim solution between a fully family run board and a board with one or more formally appointed non-executive outside directors. An advisory board allows for a transition in the formality of the way a family business operates and the degree of accountability and challenge an owner-founder faces as leader.

(2) Board of Directors

As the business grows and ownership and management roles are separated, the board often becomes more formal and professional in its role: providing feedback, confirming the management's actions, planning continuity and assessing performance. An effective board facilitates continuity planning in two fundamental ways. The board holds management accountable to early planning and demonstrates to the next generation that the family is committed to increasing professionalism in ownership and management, as well as to new ideas.

(b) Legal and Tax Planning

As has been noted, while formal agreements and legal structures regulating owners are helpful and, indeed, often required for the successful continuity of family enterprise, experience shows that these tools are not sufficient in and of themselves. There is no legal agreement or structure that, at the end of the day, does not depend on the goodwill and commitment of the people whose life it sets out to regulate. With that proviso in mind, fundamental planning tools include tools to provide for retirement and death - shareholders' (or partnership or other co-ownership) agreements, trusts, outright gifts, marriage agreements and wills - as well as tools to plan for incapacity - trusts, powers of attorney and delegation of corporation authority. What follows is a very concise summary of the main succession planning tools in the context of family business succession.

(i) Estate Planning Tools

(1) Shareholders Agreements

A comprehensive shareholders agreement is a key tool in ensuring the smooth succession of business interests from one generation to the next. It can also ensure that no such interests succeed to persons other than those who are intended to be part of the family business. The agreement may also serve as a tool to reinforce family governance strategies put in place to facilitate inter-generational participation in the business. By providing safeguards to the potential risks inherent in permitting the next generation to acquire ownership in a business, the agreement can facilitate broader ownership of the family business.

At its essence, a shareholders agreement sets out the rules for co-ownership of any family enterprise. The shareholders' agreement that governs a family business that aspires to extend to multiple generations must address the various events that typically occur in the life of a family: marriage, illness, disability or incapacity, divorce, difficulty with creditors, retirement from the family business and family disputes. Key to such an agreement is the flexibility to adapt to changes in both the family's and the business' circumstances.

Many family owned business have no shareholders agreement in place, particularly in the early years when owners rarely believe that such an agreement will be necessary, either because succession is not yet a priority or because of a belief that family members will reach agreement when necessary. The best time to implement a shareholders' agreement is while the founder-owner is still alive and in control of the business. Unfortunately, too many business owners appreciate the need for a shareholders agreement only when it truly is needed because a dispute has arisen which the agreement could have resolved or avoided. At that stage, it's too late.

(2) Trusts

There are many benefits afforded by the use of an *inter vivos* trust to facilitate the transfer of wealth, including:

1. centralized asset ownership and management of assets;
2. flexibility in determining the method of future wealth distributions;
3. enhanced asset protection for beneficiaries from third-party claims, including potential creditor and other actions;
4. increased confidentiality; and
5. potential avoidance of probate procedure and consequent probate fees.

A key feature of a trust is the separation of ownership and control of an asset from the benefit of that asset. This separation of ownership and control of an asset from the benefit of it makes the trust a very useful tool in the preservation of wealth and the succession of the family business. The founder of the family business is able to direct which elements of the business are to be transitioned to the next generation or other parties, transfer those elements into a trust, retain control of them by acting as trustee and, as and when she considers appropriate, make distributions out of the trust. In this manner, she can affect the transition of ownership gradually, with the flexibility to respond to changing circumstances.

There are many complexities inherent in trust drafting and the applicable tax rules. Trusts are often entered into in the context of a tax driven corporate estate freeze. The importance of current and competent tax advice is particularly crucial in light of recent changes to the taxation of trusts introduced by the federal government. A comprehensive discussion of taxation considerations in the context of business succession is beyond the scope of this paper.

(3) Marriage Agreements

When a marriage or marriage-like relationship breaks down, a division of property of the spouses occurs. The impact of that division of property on a family business can be significant and can disrupt the most sophisticated of continuity planning. Family members often wish to keep the business in the family, which often means not in the hands of an estranged spouse. A well drafted marriage agreement can reduce the risk of an estranged spouse acquiring an interest in the business and thus is an important part of continuity planning for family enterprise.

The main objective of a marriage agreement in the context of the family enterprise is to ensure that the business interests or other assets, whether held directly or indirectly through a trust of which the family member spouse is a beneficiary, remain the property of the family member spouse on marriage breakdown. If a marriage agreement is to achieve the desired result, it is critical that each spouse fully discloses his or her respective assets and their value to the other as a pre-condition of signing the agreement. Transparent and full disclosure will face impediments if a founder doesn't wish to disclose valuations to her child or grandchild, if the interest is in a discretionary trust is difficult to quantify and/or if the expense of formally valuing the business interest will be prohibitive.

Even in the instance of full and accurate financial disclosure, a well drafted agreement and with both parties obtaining independent legal advice, there can be no guarantee that the agreement will escape judicial intervention upon marital breakdown. That said, an agreement is certainly better than none and can serve as a valuable communication tool for family members and their spouses on the nature of family enterprise assets, their value and family expectations in terms of continuity planning.

(4) Other Tools, Including Wills

When advising clients on continuity planning, some of the other estate planning tools can include:

- rearranging property ownership;

- use of joint tenancy ownership;
- life insurance, and specific beneficiary designations, or life insurance trusts;
- annuities;
- RRSP's and RIF's; and
- last, but not least, the will.

A will is an essential part of a plan to distribute an estate on death, but it is only one part. Arranging property interests in different ways during one's lifetime can accomplish some or all of the intended distribution. A will must be drafted to accommodate the overall estate plan.

Even if there has been a complex estate plan put into place with trusts and other structures, there are almost always some assets that have not been dealt with and which must be taken care of by the will. In addition a will appoints an executor, who has legal authority to administer an estate, including defending or pursuing any legal claims against the estate. Common planning for families who own private businesses is to enter into multiple wills, where often the corporate assets will be governed by a second, non-probated will. It's essential that such planning is carefully considered in terms of drafting and income tax considerations to prevent unforeseen problems later. In summary, no matter how simple or complex an estate plan is, a will is essential for all continuity plans.

(5) Incapacity Planning: Power of Attorney

A lack of adequate planning for incapacity can result in significant damage to the assets and operational health of a business if a key family member is suddenly found to be incapable. In the absence of the required documents, it could be necessary to appoint a committee or adult guardian for a family member, which is time consuming, onerous and could be damaging to the viability and goodwill of a business.

Execution of an enduring power of attorney in advance of any incapacity will confer authority on another person or corporate entity to carry on the family member's legal and financial affairs, including managing a business and other assets. Consideration should be given to the preparation and execution of multiple powers of attorney, including one that provides limited powers to carry on the business. In this manner, a separate attorney can be appointed to manage each of the business and personal assets. An attorney with the correct skills and knowledge can be put in place to ensure a smooth continuity of a business in the event of the unexpected incapacity of a key manager.

(ii) Tax Avoidance Strategies

The *Income Tax Act* is extremely complicated and almost incomprehensible to the average tax payer and business owner. Overlay on top of that complexity are increasingly restrictive tax rules for owners of private companies in Canada. The recent changes, particularly as they relate to tax on split income ("TOSI") and changes to the taxation of passive income, are exceedingly complex. These new tax measures, which were first proposed in July 2017, are now enacted as of January 1, 2018 and may present significant and unexpected challenges for private corporations and their owners.

Family enterprises, which exist in layers of family, ownership and business complexity, now face an increasingly complex taxation landscape, with significant ramifications on their ability to maintain and transfer wealth. There will be a lengthy period of uncertainty ahead with respect to the new tax rules. In terms on continuity planning, family business owners will need to revisit existing structures, including estate freezes and trust planning, to assess the discount on their earnings and reduced ability to retain capital in their corporations, among other impacts, that the new rules represent.

(c) Ongoing Continuity Planning

As the business matures or passes from family hands to subsequent owners, wealth management becomes a more pressing issue than was the case during the wealth-creation phase of the business family's evolution. Whether or not the family has sold or otherwise exited from the operating business, as the relative value of wealth increases, the family must decide if they wish to remain connected through coordinated management of their wealth or should they pursue separate destinies. The route a family chooses will likely be influenced by the events that led to the sale of the business, if applicable, the scale of the assets they have realised and the degree of commitment and loyalty they have to the family as a unit.

Families who successfully manage a collaborative approach to wealth management over time often have the following approaches:

- a united sense of mission of what they are trying to achieve long term;
- an approach to governance that recognizes that as a family grows in complexity, it will need increasingly sophisticated decision making structures;
- an awareness that power and control will need to be managed and delegated consciously and carefully;

- an appreciation that while great efforts were expended to build the wealth, that same effort will need to be sustained, refreshed and renewed if the family is going to continue to be successful in the future.[48]

(i) Family Office

A family office is a means by which a family coordinates its financial affairs. The need or wish for a family office is usually driven either by a requirement for coordination of the liquid portion of wealth or by a significant increase in family liquidity and the desire to retain some degree of control over the management of the proceeds of that occurrence. A family office is a means for a family to maintain control over the way they preserve and grow their wealth while at the same time being a focal point of contact for the family and their numerous advisors.

Available forms of family offices are:

- a single family office;
- an independent multi-family office;
- private banks and/or asset managers; and
- a do it yourself model, possibly with external consultants.

A family office provides services in a wide breadth of competencies at the election of the family, most commonly:

- Family meeting coordination;
- Development and maintenance of governance structures;
- Family education;
- Conflict prevention and conflict resolution ,where required;
- Tax, estate and financial planning;
- Wealth transfer planning;
- Asset protection and other risk management;

[48] Rylatt, *supra* note 41 at 249.

- Investment consulting, monitoring and performance measurement;
- Philanthropic planning and foundation management; and
- Financial recordkeeping, compliance and consolidated reporting.

Family offices come in different forms and are an option for the integration and management of financial assets and other matters for families with significant wealth. For families with a cohesive and strategic approach to wealth management, they perform an important function for the maintenance of long term wealth across generations.

4. Managing the Continuity Planning Process

(a) Redefining the Client

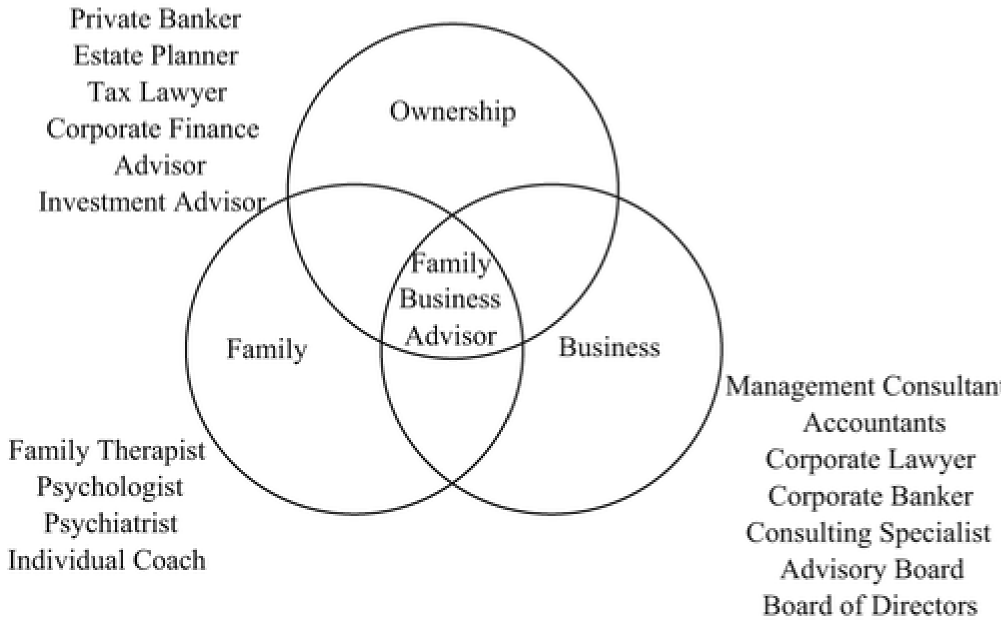
Many times, an advisor thinks of the individual who created the business as his or her client. However, in the context of a family business, the client can be thought of as the whole family relationship. Serving multiple clients may complicate matters for the family advisor but it can prove to be much more rewarding and effective for the larger family enterprise system when critical information is not kept in one subsystem or professional silo. Accordingly, advisors must learn to expand their definition of client both in a longitudinal and latitudinal fashion. The advisors must expand their understanding of the family relationships over multiple generations (longitudinal). They must also look at the growth of families to include in-laws or, as many clients like to call them, out-laws (latitudinal).

For lawyers who practice within the confines of conflicts rules and the Code of Professional Conduct, a broader conception of the client presents a unique retainer challenge. One way to address conflicts issues is to enter into a written agreement with the initial client, often the owner-founder, that permits communication and information sharing with other family members and professionals working together as a multi-disciplinary team. The more specific the information sharing agreement, the better, to avoid misunderstandings or difficulties which may arise, particularly in the event of family conflict.

(b) Building and Leading a Multi-Disciplinary Team

Continuity planning for family owned businesses often brings together professionals from diverse disciplines, including lawyers, accountants, family therapists and management consultants.

Advisors may work in one or more of the three systems:



[49]

These professionals have traditionally worked with families independently of one another and didn't have a chance to compare their lone perspectives and form a more complete and holistic picture of the family enterprise system to better serve families. Independent advising has often lead to the family business client receiving different or even conflicting advice from different advisors. To improve the quality and consistency of advice, researchers have suggested that advisors from different disciplines work collaboratively and take all three subsystems - that is, family, business, and ownership - into account in addressing the issues facing the family enterprise .[50]

While working in multidisciplinary teams using a systems perspective provides a more comprehensive and coordinated approach to assisting a business family, particularly through the continuity process, this approach is not without its challenges. Consulting with multiple professionals is time consuming and requires a strong commitment to managing the process of the team. Whether it is codified in a formal multi-disciplinary charter or informally coordinated, effective teams require a leader who is recognized and respected as the team's organizer and facilitator. Advisors who have developed the most enduring relationships with business families were often able to do so by "quarterbacking" a larger advisory team. The benefit to the family of integrating advice is increased decision quality and accuracy.

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[49] Vanessa M Strike, "Advising the Family Firm: Reviewing the Past to Build the Future" (2012) 25:2 Family Business Review 156.
[50] W Gibb Dyer, "Potential Contributions of Organizational Behavior to the Study of Family-Owned Businesses" (1994) 7:2 Family Business Review 109.

In summary, advisors, with the proper professional training, skills, and processes in hand, can have a positive impact on the economic and noneconomic value and wealth creation of family enterprises. This can largely be attributed to advisors who help the family understand that there are ways to manage the firm that are more effective than traditional management and operational patterns developed by the family. Moreover, as family firm advisors work together to integrate multidisciplinary advice, they can better assist the business family prepare for wealth transitions.[51]

VI. Conclusion

A new approach to continuity planning is a family first, multidisciplinary approach, in the context of the overall business family system. Governance provides structures to facilitate communication and clarify a united vision. On that foundation, critical legal and tax structures will then enable a family to build and transfer its unique version of transgenerational wealth.

[51] Trish Reay, Allison W Pearson & W Gibb Dyer, "Advising Family Enterprise: Examining the Role of Family Firm Advisors" (2013) 26:3 Family Business Review 209.

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