Institute for
Family Business

Understanding Family Business

A Practical Guide for the Next Generation

Andrew Drake

next generation

Institute for
Family Business

Understanding Family Business

A Practical Guide for the Next Generation

Andrew Drake

next generation

Institute for
Family Business

About IFB

The Institute for Family Business is a not-for-profit membership association which supports the UK family-owned business sector through Advocacy, Education and Research. As a voice for family firms, IFB Advocacy promotes the vital contribution that long-term family businesses make to the UK economy. IFB Education (which includes the Next Generation Forum) provides a peer network for sharing best practice and knowledge. The IFB Research Foundation fosters deeper understanding of the unique issues which confront family firms.

Growing successful enterprises
for generations to come

Foreword

Family businesses represent the most enduring business model in the world. The continuing success of family firms through the generations relies on ensuring that the next generation, to whom the baton will one day be passed, are motivated to take up the challenge and are fit for the job at hand.

Our nation draws great strength from families who, generation after generation, foster the spirit of entrepreneurship. For young people this means taking action in their lives to make a positive contribution in whatever profession or vocation they choose. Business families often have a strong culture of "doing", where parents instil in the next generation a sense of responsibility for their future and a desire to set ambitious goals.

For those whose destiny and privilege it is to work in, or be an owner of a family business – for any young family member who is stepping up to these responsibilities – this guide will be a useful resource. It will provide practical knowledge and information to help you on your way.

Wishing you the best of luck!

Jonathan Warburton
Chairman
Warburtons

Contents

7 Foreword
10 Introduction
11 Acknowledgements

13 Section 1: Family businesses
13 What is a family business?
14 Different types of family business
16 Family businesses compared with other businesses
17 Becoming involved in a family business

19 Section 2: Owning shares in a family business
19 Becoming a shareholder
20 Limited liability
20 Your rights and entitlements as a shareholder
22 Different classes of shares and share rights
22 Shareholders' meetings and resolutions
24 Your influence as a shareholder
24 Family trust shareholdings
25 Charging your shares

29 Section 3: Becoming employed in a family business
29 Are you eligible?
29 Mentoring and career planning
29 Your terms of employment
30 Your rights and duties as an employee
31 Leaving employment

33 Section 4: Becoming a director
33 Executive and non-executive directors
33 Being appointed a director
33 Your duties as a director
35 Your authority as a director
35 Board meetings and resolutions
37 Personal liability
38 Limiting and insuring against your liability as a director
38 Rights to information

41 **Section 5: Governance and administration**
41 What is governance?
41 Non-executive directors
42 The company secretary
42 The family council
44 The family office

47 **Section 6: Important family business documents**
47 Articles of association
47 Shareholders’ agreements
48 Family charters

51 **Section 7: Taking money out of the family business**
51 Salary and dividends
51 Selling your shares
52 Share buy-backs

55 **Section 8: Financing the business**

59 **Section 9: Professional advisers**

63 **Section 10: Making a success of your involvement**

65 **Glossary of terms**

Introduction

Often the younger members, or next generation, of a family that owns a business become involved without anyone explaining to them what their involvement means in practice. They may take a job in the business or perhaps, at a later stage, be asked to join the board of directors. They may be beneficiaries of a family trust that owns shares in the business or become shareholders in their own right.

This legal guide, which the IFB is privileged to publish, sets out to explain what such involvement means and provides an explanation of how family businesses are typically governed and administered. It also describes some of the more important documents that govern the way in which the business is run and the family's relationship with their business.

For the reader's added enjoyment we have included cartoons by the late Phil Interlandi, which illustrate the lighter side of family business.

We hope that you will find this handbook enlightening.

Grant Gordon
Director General
Institute for Family Business

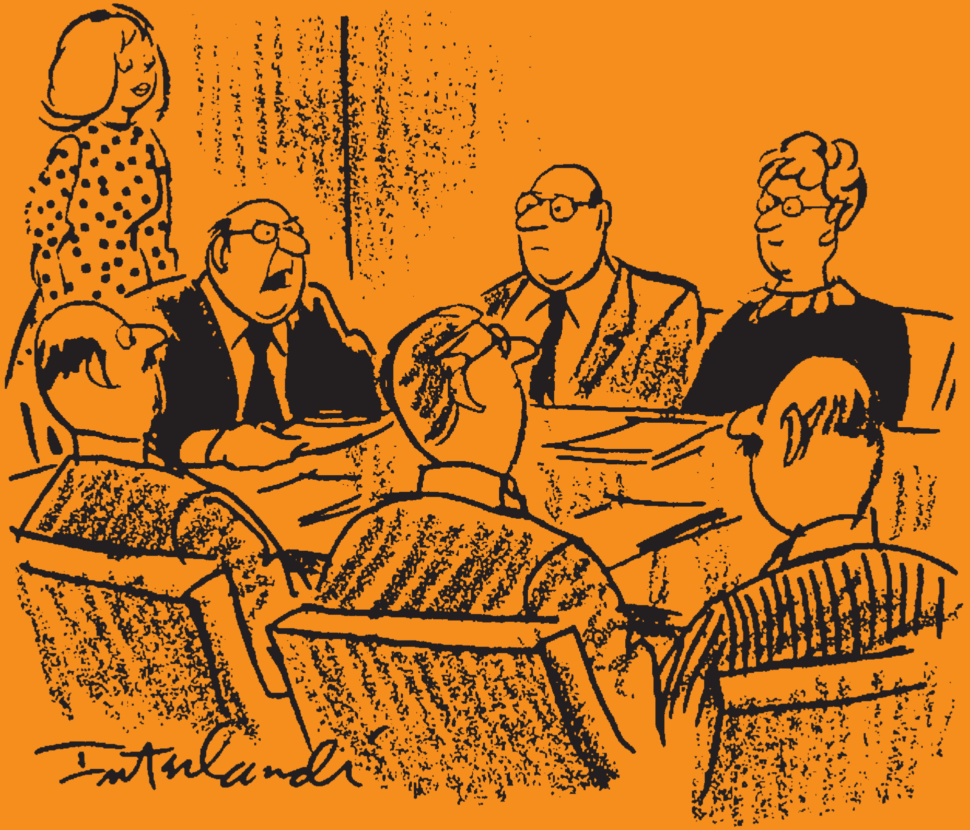
Acknowledgements

This guide has been made possible through the involvement and support of a small group of people. First and foremost there is the author, Andrew Drake, whose vision it was to create this handbook. Andrew spotted the opportunity to help demystify family businesses for the next generation through this publication.

Huw Davies from the IFB, who is closely involved with the IFB Next Generation Forum, recognised the importance of publishing the guide, while Grant Gordon joined the project as Editor. Last, but not least, we are most grateful to family business owners, Simon Berry of Berry Bros & Rudd and Mitul Shah of Liberty Land, for taking the time to read the guide and provide us with helpful comments and suggestions.

The author

Andrew Drake is a corporate lawyer specialising in advising family businesses. He is a member of the Advisory Council to the Institute for Family Business and has spoken and written widely about legal issues affecting family businesses.



Am I to understand, Mother, that “fiddle-faddle” and “pooh” mean you disagree?

1 Family businesses

What is a family business?

There is no legal definition of a family business and commentators tend to define family businesses in a variety of different ways. For some, the definition is as broad as "any business that regards itself as a family business", even if family members are no longer involved in management and/or ownership. In other words a family business ethos is enough for the business to qualify as a family business.

A more common and narrower definition runs along the following lines:

- the family owns a majority of the voting shares or effectively controls the business and
- one or more family members (or their spouses) are involved in the management of the business and
- more than one generation is, or will in future, become involved in the business.

It is really the last of these three points that distinguishes family businesses from owner-managed businesses, because owner-managed businesses are not necessarily passed down to the next generation.

Where a business is run through a company listed on the stock exchange, that company is often defined as a family business, in ownership terms, if the family holds not less than 25% of the voting shares and the remainder of the shares are held by smaller minority shareholders.

Family businesses come in many different shapes and sizes. Some family businesses are extremely old, some are substantial international businesses and some are owned by more than one family.

The UK's oldest family business is believed to be John Brooke & Sons from Huddersfield, which was founded in 1541. An example of a substantial, international family business is property group, Grosvenor, owned by trusts on behalf of the Duke of Westminster and his family. The famous wine merchant, Berry Bros & Rudd, is an example of a business where two families, the Berrys and the Rudds, are active in the business.

Different types of family business

Companies, Partnerships and LLPs

For the most part this guide assumes that the family business is carried on through a limited company. However, it is important to recognise that a number of family businesses are carried on through a general partnership or a limited liability partnership (an LLP), in which case different considerations will apply. An LLP is a hybrid between a company and a general partnership, in that it is taxed like a partnership but in terms of its relationship with third parties it is more like a company.

Some of the key distinctions between these three different legal structures are as follows:

- ***Shareholder liability.*** Shareholders in a limited company enjoy limited liability (see Section 2, page 18). Partners (or members) of an LLP also enjoy limited liability (subject to certain exceptions), while the partners in a general partnership have unlimited liability.
- ***Taxation.*** A limited company is taxed on the profits it makes, whereas the partners or members of both a general partnership and an LLP are taxed personally on their share of the profits of the partnership or LLP. The shareholders in a limited company are taxed on any dividends or salary received.
- ***Separate legal entity.*** Both a limited company and an LLP are separate legal entities and can enter into contracts in their own name. In contrast, there is no separate legal entity involved in a general partnership – the partners contract in their own names.
- ***Public disclosure.*** Both limited companies and LLPs are required to file financial accounts and other information with the Registrar of Companies. Subject to certain exemptions for small businesses, the accounts must be audited. All information filed can be inspected by the public. General partnerships are not required to file any accounts or other information with the Registrar and are also not required to have their accounts audited, irrespective of size.

- ***Articles of association compared with partnership or membership agreements.*** The constitution of a limited company is set out in a document called the memorandum and articles of association. The memorandum is of little practical significance and the more important document is the articles of association (described at the start of Section 6, page 45). The articles are filed with the Registrar of Companies and so are open to public inspection.

The relationship between the partners of a general partnership or the members of an LLP is set out in a partnership agreement or a membership agreement, respectively. There is no requirement to file either of these documents and so they remain private.

Although the articles of association are open to public inspection, the shareholders of some family businesses run through limited companies may have entered into a shareholders' agreement (see Section 6, page 45). Most shareholders' agreements do not have to be filed with the Registrar of Companies and are therefore private documents.

Public and private limited companies

In the case of family businesses that are run through a company, there is a further distinction to be drawn between a public and a private company.

The majority of family businesses that are carried on through a limited company are carried on through a private company. However, there are some family businesses carried on through a public company (a PLC).

A PLC differs from a private company in a number of ways. The following are some of the more notable differences:

- A PLC is able to offer its shares to the public, but a private company is not permitted to do this.
- The requirement for a private company to have a company secretary (the chief administrative officer of the company) has recently been abolished, but a PLC is still required to have one.
- A PLC must have a minimum issued share capital of £50,000.
- The *City Code on Takeovers and Mergers* applies to a PLC (even if its shares are not listed).

- PLCs are subject to stricter legal requirements than private companies in relation to matters such as:
    - payment for shares
    - making loans to directors
    - paying dividends to shareholders
    - the purchase and redemption of the company's shares
    - the requirement to have the company's accounts audited and
    - the period within which the company must prepare and publish its annual accounts.

Family businesses compared with other businesses

Much has already been written about the commercial strengths and weaknesses of family businesses, as compared with other businesses. For example, it is often said that their strengths include a genuine passion for and pride in the business, a greater willingness to think about and invest for the long term, and a desire for stability in terms of relationships with customers and suppliers. Weaknesses often cited include a failure to plan for succession, a confusion between what is family and what is business, and problems encountered in attracting and retaining non-family executives.

One of the principal differences between a family business and any other business is that it is quite common within a family business for a family member to be involved in the business in a number of different capacities and to "wear different hats". For example, he or she may be:

- an individual shareholder
- a trustee of a family trust that owns shares in the business (see Section 2, page 22)
- a director
- an employee.

It is important that family members are aware of the possibility of conflicts arising as a result of the different positions held in relation to the business. For example, it is quite possible for a situation to arise where a family member's duties as a director conflict with his or her duties owed as a trustee. Family members must therefore be alert to the potential for conflict and, if necessary, take professional advice.

Becoming involved in a family business

As a member of a family that owns a business you may become involved in that business in different ways. For example, you may:

- purchase, inherit or be given shares in the family business and/or
- become a beneficiary of a family trust that owns shares in the business and/or
- become an employee and/or
- become a director.

The purpose of this guide is to explain what such involvement means in legal terms where the business is carried on through a limited company.

I can’t tell you how pleased I was to learn that Dad left all of us equal shares...

2 Owning shares in a family business

Becoming a shareholder

Are you eligible to be a shareholder?

Whether you will be able to own shares in the family business will depend on what the family's policy is on share ownership and whether there are restrictions on the persons to whom shares can be sold, given or bequeathed (see more about this in Section 7, page 49).

Families can have different views on share ownership. Some families have a policy that shares (or possibly shares with voting rights) can only be owned by family members who work in the business. Others provide that shares can only be owned by bloodline family members but that employment is not a condition of ownership. Some families allow shares to be owned by in-laws and/or non-family employees.

What are the terms on which you become a shareholder?

If you become a shareholder in the company, you effectively enter into a contract with the company that you will be a shareholder on the terms set out in the articles of association (see Section 6, page 45). The terms of your membership of the company may, however, be supplemented by the terms of a shareholders' agreement or a family charter (see Section 6, pages 45-46).

Your share certificate and the register of members

On becoming a shareholder you will be issued with a share certificate and your name will be entered in the statutory register of members kept by the company. The fact that you are a shareholder will also become a matter of public record because details of your membership will in due course appear on the company's file kept by the Registrar of Companies.

You should keep your share certificate safe. If you do lose it, the company will issue a new one to you but will usually ask you to sign an indemnity to cover any loss caused to the company as a result of the subsequent discovery of the old one.

The difference between issuing and transferring shares

You may become a shareholder in two different ways. The company may *issue* new shares to you, in which event the amount you pay for those shares goes into the company's bank account and forms part of its share capital.

Alternatively, existing shares may be *transferred* to you – i.e. sold, given or bequeathed to you – by another shareholder. If you pay anything for those shares, the price goes to the selling shareholder as opposed to the company. Each issue or transfer of shares is normally approved by the directors at a board meeting or by an authorised committee of the board.

Many businesses will try to avoid issuing new shares because they dilute the equity stakes of existing shareholders.

You are not required to pay any stamp duty on shares that are issued to you. If, however, you purchase shares from another shareholder you will have to pay stamp duty on the purchase price. Gifts of shares do not bear stamp duty.

Share premium

Shares in a company have what is called a par or nominal value. Often this is £1. For example, many private companies are formed with an initial share capital of £1,000 divided into 1,000 shares of £1 each (although sometimes the par or nominal value may be different – for example 10p or 1p). If shares are issued to you and you pay more than the par or nominal value, the excess over that value is known as the share premium. In other words if you pay £2 for a £1 share, the share premium is £1.

Limited liability

One of the most important characteristics of a limited liability company is that if you become a shareholder, your liability as a shareholder is limited to the amount that is unpaid on the shares that you own.

This position should be contrasted with that of a partner in a general partnership. Partners in a general partnership have unlimited liability and so, for example, a partner's personal assets can be taken to satisfy the debts of the partnership.

Your rights and entitlements as a shareholder

What you are entitled to if you become a shareholder will depend to a certain extent on the type (or class) of shares that you own (see also "Different classes of shares and share rights" on page 20). If the share capital consists of only one class of ordinary shares, then it is likely that your rights will be as follows.

Financial entitlements

You will be entitled to receive:

- the relevant proportion of the total amount of dividends paid in each year, the relevant proportion being the percentage of the issued share capital owned by you, and
- the same proportion of any capital repaid, if, for example, the company were ever to be liquidated.

You should bear in mind that dividends can only be paid if the company has enough "distributable profits", an accounting term that is defined by statute. However, even if this statutory test is satisfied, the directors must also consider other matters when deciding whether to pay dividends, such as the future cash requirements of the company and whether any of the profits should be reinvested in the business.

Most articles of association provide that dividends are declared by ordinary resolution at a shareholders' meeting, although the amount must not exceed that recommended by the directors. Additionally, directors are often given the right to pay interim dividends, if the profits justify this.

Voting rights

You will be entitled to receive notices of, and to attend and vote at meetings of the shareholders, called general meetings (see "Shareholders' meetings and resolutions" on page 20).

Rights to information

Your legal rights as a shareholder to information about the company are not nearly as extensive as those of a director. You have no right to see any financial information about the company other than that contained in the company's annual accounts. You have no right, for example, to see any management accounts of the company. You also have no right to see minutes of board meetings, unless you are also a director.

Some family businesses will, however, as a matter of practice voluntarily provide shareholders with more information than is in the annual accounts of the company. In some cases the right to receive additional information may be contained in a shareholders' agreement or family charter (both discussed in Section 6, pages 45-47).

Different classes of shares and share rights

The share capital of the company will vary from business to business. It might be divided, for example, into ordinary shares of £1 each, all of which have the same rights. Alternatively, for example, the share capital might be divided into:

- "A" shares that have the right to receive dividends and a return of capital, but which have no voting rights and
- "B" shares that have voting rights, but no rights to receive dividends or capital.

Some family businesses may have preference shares, which have very limited voting rights but carry a preferential right to receive a fixed dividend (before any dividends are paid to other classes of shareholder).

The concept of different classes of shares can be very useful, either in terms of meeting the differing expectations of family members or in terms of distinguishing between family members. For example:

- Family members who are employees may be less reliant on dividend income than those who are not employed in the business (because the former receive a salary). Some families recognise this by issuing those shareholders who are not employed in the business with a class of share that carries a fixed preferential dividend.
- Large multi-generational family businesses may have different classes of shares corresponding to different branches of the family, so that one branch might have "A" shares, another branch "B" shares and a third branch "C" shares.

Shareholders' meetings and resolutions

Annual General Meeting (AGM)

Most family businesses will hold at least one shareholders' (or general) meeting each year, known as the annual general meeting or AGM (although under the Companies Act 2006 private companies are not obliged to hold AGMs unless required by their articles of association). In addition the directors may convene from time to time other general meetings to deal with any issues that require shareholder approval and that cannot wait until the next AGM (for example, a change in the share capital).

Matters normally dealt with at an AGM are:

- the approval of any dividend recommended by the directors

- consideration of the company's annual financial accounts and the reports of the directors and auditors
- the election of directors
- the appointment of the auditors for a further year and
- giving the directors authority to fix the auditors' remuneration.

The need for a quorum
In order for a shareholders' meeting to be validly held, the articles of association will provide that a minimum number of members must be present, known as a quorum.

The chairman
The chairman of the board normally acts as chairman of each general meeting.

Proxies
If you are unable to attend a shareholders' meeting the articles of association may allow you to appoint someone, known as a proxy, to attend and vote on your behalf.

Voting
When a resolution is put to the vote at a shareholders' meeting it will normally be decided on a show of hands, unless a poll is demanded. The articles of association will set out who is entitled to demand a poll. On a show of hands every member normally has one vote, but on a poll each member normally has one vote for each voting share that he or she owns. However, some family businesses with a substantial number of shareholders may have articles of association specifying, for instance, that ten shares equals one vote.

Special and ordinary resolutions
Most resolutions will be passed as either special or ordinary resolutions. Ordinary resolutions must receive the approval of more than 50% of the shareholders (on a show of hands) or the approval of shareholders holding more than 50% of the voting shares (on a poll). Where the resolution is a special resolution the level of approval required is 75% or more of the shareholders (on a show of hands) or shareholders holding 75% or more of the voting shares (if there is a poll).

Special resolutions are required for important matters such as:

- changing the name of the company
- changing the articles of association
- changing the status of a private company to a public company and
- a share buy-back (discussed in Section 7, page 49).

Written resolutions

With certain exceptions, shareholders of a private company can also pass shareholder resolutions by written resolution, so avoiding the need to hold a shareholders' meeting in order to approve the relevant resolutions. As a result of recent changes in company law, private companies are now able to pass written ordinary resolutions by a simple majority of those shareholders eligible to vote, and written special resolutions by a 75% majority of those eligible to vote. Previously unanimity was required for all types of written resolution.

Your influence as a shareholder

Your influence will depend on the percentage of voting shares you own. Particularly significant percentages are:

- 26% to 49% (because this enables you to block a special resolution)
- 50% (because this enables you to block an ordinary resolution)
- more than 50% (because this enables you to push through an ordinary resolution) and
- 75% or more (because this enables you to push through a special resolution).

Family trust shareholdings

What are family trusts?

It may be that your family circumstances are such that you are not given the opportunity to become a shareholder in the company but you are a beneficiary of a family trust that owns shares in the company.

It is quite usual for a number of shareholdings in a family business to be held by trustees of one or more family trusts. These trusts may have been established for estate planning and/or business succession or continuity reasons and/or to try and protect the shares in the event of family members divorcing or becoming bankrupt.

When shares are put in trust, they are placed under the control of trustees for the benefit of certain persons (known as beneficiaries). The trustees will typically be family members and/or trusted advisers and/or close family friends. The beneficiaries will typically be descendants of the person who originally placed the shares in trust (known as the settlor). The identity of the beneficiaries may be set out in the trust document or the trustees may be given power to select individual beneficiaries at a later stage.

What happens when shares are put into a family trust?

The main characteristics of a family trust are:

- While the shares are under the control of the trustees, they are separate and distinct assets from the trustees' personal assets.
- The legal title to the shares is held by the trustees and, from the company's standpoint, whoever of the trustees is first named on the register of members is the person entitled to exercise any voting rights attached to the shares. However, as a matter of trust law, the trustees must always act unanimously, unless provided otherwise in the trust document. None of the beneficiaries has any voting rights.
- The trustees must deal with the shares in accordance with any specific directions set out in the trust document and any duties imposed by trust law.
- The shares cease to be the property of the settlor.
- The trustees are accountable to the beneficiaries for what they do or omit to do.

What are your rights as a beneficiary?

The rights of beneficiaries to see trust documentation or information relating to the administration of the trust vary according to the type of trust and the beneficiaries' interests in it. This is an area that can be complex and on which professional advice is needed, depending on each individual trust's circumstances.

Charging your shares

If you acquire shares in your family business, and those shares are of some value, you may wish to borrow on the security of those shares by, for example, charging them to the bank.

You need to proceed carefully before considering this. Any charge may be prohibited under the articles of association or one of the other documents referred to in Section 6 of this guide. Also, even if a charge is not prohibited, if you were unable to repay the borrowing and were to lose control of your shares, this could very well cause considerable difficulty in the context of a family business.

The implications of selling some or all of your shares are covered in Section 7 (page 49).

Post this immediately: “My statement in the company newsletter that we considered all our employees to be part of the family *was only a figure of speech!”*

3 Becoming employed in a family business

Are you eligible?

Your ability to become an employee of the family business will depend on whether the business has a genuine need for your services and whether you have sufficient talent, qualifications and experience to do the job concerned. There are still some family businesses that will try and find a way of employing all family members (irrespective of ability), running the risks that come with nepotism. However, most successful family businesses are genuine meritocracies and you should expect to have to prove yourself.

Some family businesses require family members to have gained experience in another business (typically for not less than two years) before they are taken on. You should check what the family expects and whether any particular qualifications would be valued by the business.

In larger family businesses the rules for becoming an employee may be set out in a family charter (discussed in Section 6, page 46).

Mentoring and career planning

Some family businesses will assign a mentor to a family employee. The mentor's role is to assist and support you in learning about the business and provide a sounding board in relation to your career development, as well as any new ideas you might have for the business. It is helpful if the mentor is not a relative, to ensure that emotional family bonds do not affect the mentoring process.

The lack of a career plan for family employees can often be an area of weakness in family businesses. You should therefore make sure that the company has provided you with a career development plan that has been thought through, and with which you are happy. A mentor may well be able to assist you with this.

Your terms of employment

Assuming that you wish to become an employee and that the business is prepared to take you on, you must make sure that you are provided with a contract of employment.

There is a tendency in some family businesses for the employment of family members to be dealt with on a very informal basis. An employer is, however,

required by law to provide its employees (including family member employees) with certain statutory information about their employment. Additionally, there are a number of other reasons why it is in both your interests and those of the company that your employment relationship is conducted in the same way as the relationship with non-family members:

- If family employees are treated on an "arm's length" basis it creates a level playing field. It avoids resentment among non-family employees who might, for example, otherwise be bound by restrictions in their contracts that are not imposed on family employees.
- It is particularly important in a family business for you to be clear as to exactly what is expected of you. This means making sure that your contract includes a job description providing details of the person or persons to whom you will report.
- You need to know who will be appraising your performance so that you can be provided with feedback on how your career is progressing. It is preferable for any appraisal to be carried out by a non-family director or manager.

Other matters that should be covered in your contract are:

- the salary you are to receive and any other benefits (such as any entitlement to a pension)
- the amount of notice that you and the company are required to give each other in order to terminate your employment
- your holiday entitlement
- your entitlement to sick pay
- the procedure for pursuing a grievance and
- the circumstances in which the company is entitled to terminate your employment with immediate effect.

Your rights and duties as an employee

You will have, as a family employee, all the statutory rights enjoyed by any non-family employee, such as the right to a minimum period of notice, the right not to be unfairly dismissed and the right to statutory redundancy pay (once you have been employed for the relevant qualifying periods).

You must comply with the specific duties set out in your contract of employment and certain other implied duties established by case law, such as the duty of fidelity or loyalty, and the duty not to disclose trade secrets or confidential information belonging to the company.

Leaving employment

Your employment may well not end until your retirement, but if, for whatever reason, you wish to terminate your employment, then you will need to make sure that you give the required period of notice.

Depending on the seniority of your job in the family business and the nature of that job, there may be restrictive covenants in your contract of employment that prohibit you for a certain period from undertaking activities that are competitive with the family business, from soliciting customers or clients of the business or from poaching its employees. You need to ensure that you observe these covenants.

If you do cease to be an employee, this does not by itself mean that, if you are also a director, you also automatically cease to be a director. However, some contracts of employment do contain an obligation to resign as a director in the event of employment ending.

If you are also a shareholder you should also consider what effect, if any, your resignation as an employee has on your shareholding, because some articles of association provide that shareholders who cease to be employees are required to offer their shares for sale to the other shareholders.

Your father says that's the way it *is*. You *are* all desk and no authority.

4 Becoming a director

Executive and non-executive directors

There are two types of directors, executive and non-executive directors. Put simply, if you become a director and are also employed in the business, then you will be an executive director. If you become a director but are employed elsewhere, then you will be a non-executive director. Non-executive directors are normally paid a fee for serving as a director and are reimbursed any expenses incurred in attending meetings. The terms on which non-executive directors serve are normally set out in a brief letter of appointment.

Directors should ideally be appointed on the basis of their qualifications, experience and ability to contribute to strategic decisions made by the board of directors.

Being appointed a director

Directors are normally appointed either by the board or by an ordinary resolution of the shareholders. When they are appointed by the board, the articles of association may provide that the appointment has to be confirmed by the shareholders at the next AGM.

The minimum age for a director is 16.

When a director is appointed, a form needs to be filed with the Registrar of Companies containing certain personal details of the director. These details are available for public inspection.

Your duties as a director

General duties

Your duties as a director are extensive. Some are established by case law and others are statutory duties. Among the more important duties are the following:

- the duty to promote the success of the company (discussed in the next sub-section)
- the duty to exercise independent judgement (for example, you should exercise your own judgement in considering recommendations by advisers)
- the duty to avoid actual or potential conflicts of interest and to declare any

personal interest in a transaction at board meetings (for example, any proposal that the company enters into a contract with another company of which you are a director or shareholder)

- the duty not to divert business opportunities for the company to yourself, and the duty not to accept benefits from third parties that arise as a result of your directorship
- the duty to use reasonable care and skill (see below)
- the duty of confidentiality (for example, the duty not to disclose to third parties, including shareholders who are not directors, confidential information about the company acquired by virtue of being a director) and
- the duty to prepare financial accounts and a directors' report and, unless an exemption is available because of the size of the company, to have the accounts audited.

Your duty to promote the success of the company

This means that you must act in the way most likely to promote the success of the company for the benefit of its shareholders as a whole. In doing this you are required by statute to take account of (among other things):

- the likely consequences of any decision in the long term
- the interests of the company's employees
- the need to foster the company's business relationships with suppliers, customers and others
- the impact of the company's operations on the community and the environment
- the desirability of the company maintaining a reputation for high standards of business conduct and
- the need to act fairly between the members of the company (something that can be particularly relevant in a family business).

The government has stated that "success" in this context will usually mean "long-term increase in value".

Your duty to use reasonable care and skill

The amount of care and skill you are required to exercise as a director is

defined by statute as that which would be exercised by a reasonably diligent person who has both:

- the knowledge, skill and experience that could reasonably be expected of someone in your position and
- any additional, skill and experience that you actually have.

For example, if you are a qualified chartered accountant, the degree of skill that will be expected of you in relation to financial matters affecting the business will obviously be greater than that expected of someone who is not qualified as an accountant.

Technically there is no distinction between executive directors and non-executive directors in terms of the care and skill they must exercise. However, it is recognised that a non-executive director will devote less time to the business than an executive director. Accordingly, the detailed knowledge and experience of the company's business that can reasonably be expected from a non-executive director will be less than that expected from an executive director.

Your authority as a director

As far as third parties are concerned, any person appointed as a director is normally regarded as having "ostensible authority" to commit the company (for example to a contract) even if he or she has no actual authority to do so. As an internal matter, no director should commit the company to a matter that has not been approved by the board or in respect of which delegated authority has not been granted to the director concerned.

Board meetings and resolutions

Decisions of the board of directors will normally be made either through resolutions passed at board meetings or by written resolutions signed by all the directors. Meetings can be held by telephone if the articles of association permit this.

As a director you will be entitled to receive notices of, and to attend, speak and vote at board meetings. There is relatively little formality required to convene a meeting. The articles of association will normally provide that any director, or the company secretary at the request of a director, can call a meeting.

Normally the articles of association will provide that no set period of notice has to be given for a board meeting. However, a shareholders' agreement may provide that a specific period of notice has to be given (see Section 6, page 45). Even if no specific period is agreed, all directors must be given a reasonable chance to attend (although often notices do not have to be given to directors who are outside the UK). Unless specifically agreed otherwise in a shareholders' agreement, notice of a board meeting does not normally have to be in writing, nor is there a requirement for a written agenda, although in practice many companies do provide a written agenda.

The quorum for board meetings (in other words the minimum number of directors required for the meeting to be valid) is often two in the case of small family businesses, but may be more in the case of a large family business.

Resolutions put to the board are normally decided on the basis of each director having one vote. In the event of there being an equal number of votes cast both for and against a resolution, the articles of association may provide that the chairman of the board can exercise a casting vote.

The frequency of directors' meetings is a matter for individual companies, but family businesses should, as a matter of good practice, hold at least four meetings a year. Many companies have a more frequent schedule of board meetings. Again, the frequency of board meetings may be dictated by a shareholders' agreement.

Board committees

The articles of association of many family businesses will also permit the board to delegate various matters to committees consisting of one or more directors.

Typical committees in larger companies are the remuneration committee, the audit committee and the nominations committee (which deals with appointments to the board).

Alternate directors

The articles of association may allow you to appoint an alternate director to attend and vote at board meetings at which you are not present, and generally to perform all your functions as a director in your absence. The identity of your alternate director may need to be approved by the board.

Personal liability

If you become a director there are circumstances in which, as a director, you could become personally liable as a result of failing to comply with your duties as a director or as a result of the company committing a statutory offence. If, for example, the company carries on trading with no reasonable prospect that it can avoid going into insolvent liquidation (known as wrongful trading), the directors can be forced to contribute financially to the assets of the company.

In practice, if you are part of a well-run business that has good professional advisers, you should have no difficulty in avoiding any personal liability, particularly if you:

- make every effort to attend all board meetings
- are conscientious in evaluating the board agenda and supporting papers
- are prepared to test and challenge assumptions, especially if you are a non-executive director
- review board minutes carefully to ensure that they are an accurate record of the matters discussed at the meeting
- make an effort to understand all documents that you are asked to sign or approve, especially the company's financial accounts
- pay close attention to contracts or transactions that involve a conflict of interest between the company and any of its directors or shareholders and, in particular, ensure that the terms are fair and reasonable and have been negotiated on an "arm's length" basis
- remain alert to, and make appropriate and prompt disclosure of, any issues that may conflict with other roles you hold in the business or the family, or that conflict with directorships or shareholdings that you have in other companies
- make sure you are familiar with the legal duties of directors, both generally and in relation to specific areas applicable to your business (for example, health and safety) and
- seek external advice from the company's or your own professional advisers if your concerns about particular issues are not being properly addressed by the board.

You will not normally be liable for the acts or omissions of any other directors unless, for example, you fail to supervise or make enquiries where there are suspicious circumstances.

Limiting and insuring against your liability as a director

In general terms, you are not permitted to limit your liability as a director, and any provision in the articles of association or in any contract with the company that attempts to relieve you from, or to indemnify you against, any liability in respect of negligence or breach of duty will not be effective.

You can, however, be indemnified against liability incurred in defending proceedings in which judgement is given in your favour or in which you are acquitted.

The company can also take out insurance against any liability that is incurred in these circumstances and can purchase that insurance for the directors. On becoming a director you should, therefore, make enquiries as to whether there is any directors' liability insurance in place.

Rights to information

As a director you have a statutory right to inspect the company's accounting books and records. You also have a more general right to inspect and take copies of documents necessary to enable you to perform your duties as a director, together with a right to obtain information on which to base your decisions.

I just had a horrible thought. What if they all actually *came* to the shareholder meeting?

5 Governance and administration

What is governance?

The nature of a family business is such that many larger family businesses will have governance structures that incorporate both corporate governance and family governance.

Corporate governance is the system by which the company is directed, with the board of directors being the body that has responsibility for the supervision and management of the business (see "Board meetings and resolutions" in Section 4, page 33).

Family governance involves the governance of the family and its relationship with the board. The family council (discussed later in this section) is part of a family governance structure and a number of family governance issues and family policies may be recorded in a family charter (see Section 6, page 46).

The governance structure adopted by your family business will depend very much on the size of the business, the size of family, the number of shareholders and whether non-family are involved in the company's management. For example, the governance requirements of a first or second generation family business may be vastly different from those of a more mature, multi-generational family business.

Non-executive directors

Non-executive directors can be a very important tool in safeguarding against some of the inherent weaknesses associated with family businesses, particularly where the non-executive is not a family member and is independent. Non-executives can, in particular:

- give a valuable, impartial view on management and ownership succession
- provide an independent opinion on which family members should be taken on as employees or invited to join the board
- help to ensure that family member employees are not unfairly favoured and have a career development plan
- bring experience and expertise from the outside world, so contributing to the strategic debate at board level, and

- play an important role on a number of board committees, particularly in relation to matters such as audit, remuneration and board appointments.

The company secretary

Although private companies are now no longer required by law to have a company secretary, many family businesses will, in practice, have a company secretary who is appointed by the directors, and who may or may not also be a director and/or an employee. The company secretary is the chief administrative officer of the company and his or her duties will typically include:

- keeping the company's statutory books up to date
- filing returns and other forms with the Registrar of Companies
- convening board meetings (as directed by the board)
- keeping minutes of board meetings
- ensuring that the correct procedures are followed in relation to the convening and holding of shareholders' meetings, and
- coordinating the preparation, filing and distribution of the company's annual report and accounts.

The company secretary has statutory and fiduciary duties, but fewer than those of a director.

The family council

A family council is part of the family governance structure and is most commonly found in larger, multi-generational family businesses.

It establishes policies or strategy on matters affecting the family and its relationship with the board. For example, it might establish policies on who should be allowed to own shares in the company or what the criteria should be for employing family members. It also may be responsible for drawing up a family charter (see Section 6, pages 46-47).

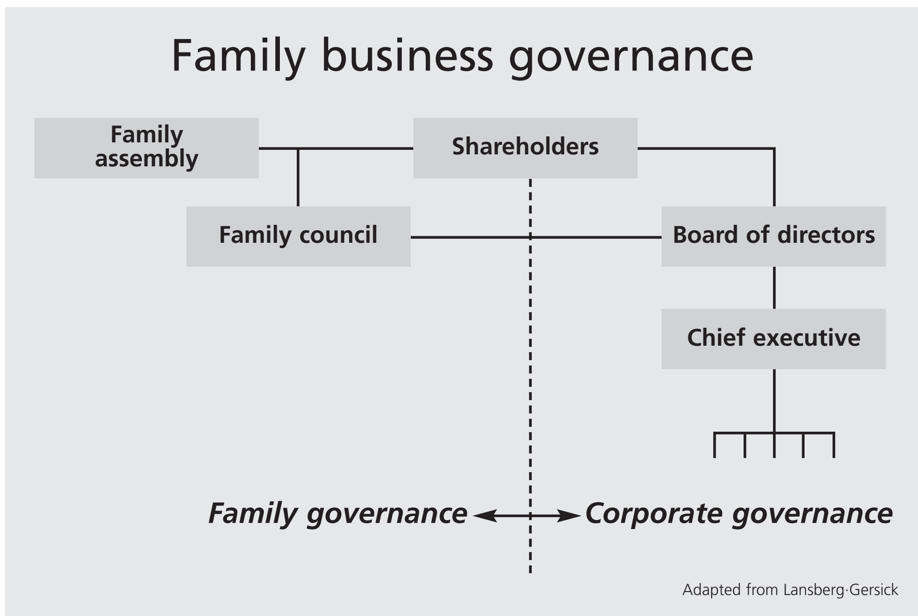
The family council differs from the board in that it is a vehicle through which the family can plan and build family unity, while the board establishes strategy and policies for the business. The council can bring together those family members who are both employed and not employed in the business, and it can also bring together the generations, ensuring that the wider family is

represented on the council. It effectively acts as a bridge between the board and the family.

If the family is particularly large then it may be appropriate to have two layers of family governance:

- a family assembly, open to all members of the family (and their spouses) and
- the family council, which constitutes a cross-section of the family and represents the wider family.

The diagram below illustrates the relationship between these family governance bodies and the board.



The family council can look at family strategic issues, such as:

- Why are the family in business together?
- What are the long-term goals?
- What are the family's values that will help to guide the business?
- What growth is the business trying to achieve?

All this can give the board, and in particular non-family management, a clear mandate as to what the family expects in terms of the way the business is conducted. The chair of the council can communicate the family's wishes to the board.

The family office

If you are part of a family operating a substantial business and/or part of a family that has sold the whole or part of the business, you may find that the needs of the family for professional support are serviced by what is called a family office.

The primary role of the family office is to provide an investment management service. It will typically deal with the accounting, management and administration of family assets, such as shareholdings in the business, investment portfolios, property holdings and charitable foundations. It may also organise matters such as tax advice, the management of staff employed by the family, and the transport and insurance needs of the family.

Where the family has substantial wealth it may itself employ professionals to staff the family office. Alternatively, families may engage third party organisations or advisers to provide these services.

There, there, now – I’m sure your father will let you retire someday.

6 Important family business documents

Articles of association

Where a family business is run though a limited liability company, the rules under which it operates are set out in what are called the articles of association.

The articles of association contain rules and procedures dealing with the administration and running of the company in relation to matters such as:

- the issue and transfer of shares (including any restrictions on transfer)
- the rights of shareholders and, in particular, where there are different classes of shares, the rights of each class of share (see "Different classes of shares and share rights", Section 2, page 20)
- notices of and proceedings at shareholders' meetings (general meetings)
- notices of and proceedings at board meetings
- the appointment and retirement of directors
- the disqualification and removal of directors and
- the payment of dividends.

Where the family business is run through a general partnership or an LLP, the rules relating to the operation of the business are set out in a partnership agreement or a membership agreement, respectively.

Shareholders' agreements

In your family business there may also be a shareholders' agreement in place. If you become a shareholder you may be required to become a signatory to that agreement. Shareholders' agreements are often entered into in order to give minority shareholders more protection than they would otherwise have under company law. For example, a shareholders' agreement might provide that no changes can be made to the articles of association without the consent of all the shareholders (whereas, under company law, changes could be made with the approval of not less than a 75% majority).

Shareholders' agreements can also be used to record matters agreed between the shareholders that would not be appropriate to insert in the articles of association because the articles are a public document.

As the name suggests, these documents are agreements between the shareholders in the company (and often with the company itself) that set out the way in which the shareholders have agreed that the company should be run. Typical matters covered in a shareholders' agreement include:

- restrictions on the company entering into certain transactions or carrying out specified matters without the approval of all the shareholders or shareholders holding a minimum percentage of the voting shares (for example 75%)
- the entitlement of larger shareholders to appoint a certain number of directors
- what the company's dividend policy will be
- how additional finance will be raised – for example, whether the shareholders will make loans or whether the finance will be raised by bank borrowing
- pre-emption rights relating to the transfer of shares (explained under "Selling your shares", Section 7, page 49). Alternatively, pre-emption rights may be contained in the articles of association.

It is often provided in a shareholders' agreement that, in the event of any conflict between the terms of that agreement and the articles of association, the terms of the shareholders' agreement will prevail.

Family charters

Family charters (sometimes referred to as constitutions or protocols) are less common than shareholders' agreements. However, they are increasingly being used by more established family businesses, particularly where some of the owners do not work in the business and there are non-family members involved in the management of the business. Family charters can vary significantly in terms of length and content.

If your family business has one, you may be asked to become a signatory to the charter.

Family charters differ from shareholders' agreements in that:

- the parties to a charter may include family members who are not necessarily shareholders (for example the beneficiaries of a family trust)

- there may be other non-family shareholders in the business (for example non-family executives) who are not parties to the charter
- shareholders' agreements are usually legally binding but family charters generally are not
- a charter will typically address certain non-legal strategic issues such as the family's goals/vision for the business, the family's values, any ethical guidelines that should be followed by the business, and any policy relating to corporate social responsibility or philanthropy.

Other matters that may be covered in a family charter include:

- proceedings relating to family meetings or meetings of the family council (see Section 5, page 40), including rules as to where and how often these meetings are held, who is eligible to be a member of the council and how the chair of the council is appointed
- key business decisions on which the board will consult with the family council
- what the dividend policy should be
- policies relating to who is entitled to own shares in the company and what happens if a shareholder wishes to sell
- rules relating to the employment, remuneration and retirement of family members as employees
- education and training for the next generation
- the establishment of an enterprise fund (or similar) that can help family members not employed in the business to start their own business ventures
- a family code of conduct.

It will be apparent from the above that there can be an element of overlap between the various governance documents and structures referred to in this section.

Your Dad wants to discuss that company Ferrari you bought while he was gone.

7 Taking money out of the family business

Salary and dividends

As an executive director or an employee of the family business you will be paid a salary. Depending on the business and the nature of your job, you may also be paid a performance bonus. Your remuneration will be paid to you under the PAYE system and you will therefore have income tax and National Insurance contributions deducted from the gross amount to which you are entitled.

If you are also a shareholder, you may additionally receive dividends on which you will also be taxed. (For more about dividends see "Financial entitlements", Section 2, page 19.)

Selling your shares

You may be able to raise funds by selling all or some of your shares, but before considering this you will need to examine the articles of association and any relevant provisions in a shareholders' agreement or family charter to see what the rules are for transferring your shares.

You may find, for example, that you are obliged to offer your shares first to other shareholders or to the company itself. The rights of the other shareholders to be offered your shares are known as pre-emption rights. There may also be specific rules covering how the price for your shares is to be calculated. Some businesses place a limit on the number of shares that can be sold in each financial period.

Note that even if you are not selling your shares but simply want to gift them to your spouse or children or other family members, you still need to check whether there are any restrictions on doing this. For example, some family businesses only permit bloodline family members to own shares and therefore do not allow shares to be held by "in-laws".

The sale or gift of your shares in the family business could give rise to a charge to capital gains tax or inheritance tax. The rules relating to these taxes are complex and you should therefore always take professional advice in relation to the tax implications of any sale or gift.

Share buy-backs

A situation can arise in family businesses where one or more family members want or are persuaded to sell their shares. This might be because, for example:

- there has been a disagreement over the future direction of the business
- a family member wants to raise capital, either to retire or to set up his or her own business or
- the family wants to reduce or eliminate a number of small shareholdings that are held by family members who have never shown any interest in the business, or by retired non-family executives.

In any of these situations the shares might be offered to other family shareholders. However, what happens if the other shareholders are unwilling or unable to purchase those shares but, at the same time, do not want to see the shares sold to "outsiders"?

One solution to this problem is for the company to implement a share buy-back. When a share buy-back occurs, instead of the other shareholders or third parties buying the shares, the company itself purchases the shares, which are then cancelled.

There are particular company law procedures that need to be followed in order to carry out a share buy-back, and the company needs to have sufficient distributable profits out of which to fund the purchase (although, in the case of a private company, a buy-back can be funded out of capital if certain additional requirements are followed).

It is also important to check whether the proceeds of sale received from the company will be taxed as dividend income or as a capital gain (in many cases, capital gains treatment may well be preferable, but a number of conditions have to be satisfied to obtain this).

The impact of the cancellation of shares bought by the company also needs to be thought about. In some situations, for example, the cancellation of shares could result in another family member acquiring or reacquiring control of the business because the percentage of the remaining issued share capital owned by that shareholder has increased to over 50%.

It’s okay. Nobody showed up.

8 Financing the business

A family business run through a limited company will typically be financed in its early stages by a mixture of equity (money paid for shares in the company) and/or loans from the family shareholders, and possibly by an overdraft facility with its bankers. Where the business is structured through a partnership or LLP, the owners will, instead of paying money for shares, invest capital in the partnership or LLP.

There are a number of differences between investing in shares in a company and making loans to that company.

If you invest in shares:

- you will be entitled to any dividends declared and paid on those shares (see Section 2, page 19)
- you will benefit from any growth in the value of the business (your shares will increase in value as the business becomes more successful)
- there are company law constraints on the extent to which you can be repaid the amount paid up on your shares, other than by selling your shares
- you may incur a tax liability on the sale of your shares.

If, on the other hand, you loan money to the company:

- instead of receiving any dividends, you will be entitled to whatever interest (if any) is agreed between you and the company – this interest can be paid whether or not the company is making a profit
- you will not normally benefit from any growth in the value of the business
- you can be repaid the whole or any part of your loan on whatever date is agreed between you and the company
- there are not normally any tax implications arising on the repayment of the loan.

As the business develops, the family may need to consider the possibility of a third party investor, particularly if the business is not self-financing and the necessary funds cannot be found from family members or the company's

bankers. Any third party investment may not necessarily be required to fund an expansion of the business but might alternatively be required, for example, to allow certain family members to exit from the business or to allow all family members to realise part of the value of their investment in the company.

There are a number of categories of third party investors prepared to consider investing in private businesses, ranging from business angels (typically entrepreneurs who have sold one or more businesses and are looking to invest some of the proceeds in growing enterprises) to private equity or venture capital funds (funds established for the purpose of investing in unquoted companies). Any investment may take the form of share and/or loan capital and, depending on the circumstances, the investor may demand one or more seats on the board of directors. Giving an outside investor a seat on the board may concern some families, but independent directors can often bring additional skills to the board (see Section 5 "Non-executive directors" page 39).

Third party investment is not appealing to some family businesses because it is regarded as a threat to the family's control of the business. Also, careful consideration will often have to be given to how any venture capital fund, or private equity investor, will be able to realise its investment, because many funds wish to exit in a three to five-year time frame.

GRABBIT,
BANKIT
&
RUNN
ATTORNEYS
AT LAW

9 Professional advisers

Your family business will have a number of professional advisers, with the exact number depending on the size, nature and complexity of the business.

It is very important that each set of professional advisers understands the nature of a family business and is prepared to work with, rather than against, the company's and the family's other professional advisers.

Most family businesses will at the very least be supported by lawyers, accountants/auditors and bankers.

The lawyers will advise in relation to matters such as:

- drafting the articles of association
- drafting shareholders' agreements and family charters (although the latter could equally be dealt with by a specialist family business consultant)
- contracts of employment
- commercial agreements with suppliers to, and agents, distributors and customers/clients of the business
- the purchase/sale and letting of property owned or occupied by the business
- the purchase of another business or the sale of the whole or part of the family business.

In the case of larger family businesses, there may be one firm of lawyers acting for the family and another firm acting for the business.

The accountants/auditors will deal with matters such as:

- the preparation and audit (where required) of the financial accounts of the family business
- tax advice (although this might equally be provided by the lawyers)
- share valuation, whether in the context of share transfers between the family, a share buy-back or an employee share scheme, and
- the purchase of another business or the sale of the whole or part of the family business.

The bankers will assist in relation to matters such as:

- the operation of the company's bank accounts and
- specific funding for projects such as capital expenditure, the purchase of property, the construction of new buildings or the purchase of other businesses.

Larger family businesses may also have a number of additional advisers, such as:

- specialist family business consultants who advise on matters like succession planning and family governance (including drawing up a family charter) and who assist in resolving disputes within the family
- chartered surveyors or planning consultants who advise on the company's property interests
- actuaries who advise in relation to any pension schemes
- strategic business consultants who advise on business strategy and processes, and
- corporate finance advisers who advise on mergers and acquisitions as well as the possible sale of all or part of the family business.

Incompetent successors, grasping in-laws, and whimpering shareholders...

10 Making a success of your involvement

The survival of so many long-established businesses is testament to the success of the family business model. There are numerous statistics showing the significant contribution that family businesses make to the economy and society in general. Becoming involved in a family business can therefore be an enormous privilege as well as hugely rewarding and exciting.

It can also, however, be demanding and challenging. Many family businesses do not make it through the generational transitions that they must navigate in order to survive. Too often a family business becomes an example of the saying "shirtsleeves to shirtsleeves in three generations".

Becoming employed in the family business may not be for everyone, but even if you are only a shareholder or the beneficiary of a family trust that is a shareholder, you may, as a responsible owner, be able to make a valuable contribution to the success of the business.

If you think that you would like to develop a career in your family business, do consider the following:

- Ask the family questions about the business, the market-place in which it operates, what the family expects out of the business and what the long-term goals are for the business. If there is a family charter, ask to see a copy.
- Find out what the family's rules or criteria are for family members seeking employment in the business.
- Think about what you could contribute to the business and what skills or qualifications you will need.
- Find out whether there are mentoring programmes available for the next generation and consider obtaining experience in another unconnected business to help build your personal confidence.
- Talk to other members of your generation about the business and form your own network of contacts with whom you can share experiences.
- If you do join, think about where you want to end up in the business. Find out who can help you with a career plan and give you feedback as your role develops.

Above all, communicate with your family about the business and encourage other members of your generation to do the same – poor communication has often been the principal cause of failure in family businesses.

If, as a family member, you have more than one role in the business – be it as employee, director, shareholder, or as trustee or beneficiary of a family trust – always be conscious of the capacity in which you are acting when dealing with others: think about which "hat" you are wearing. When relating to other family members, non-family executives or different stakeholders in the business, always think about the duties you owe and avoid conflicts of interest.

Lastly, when you eventually become a member of the senior generation, behave towards the next generation in relation to the business in the same way you would have liked your parents' generation to behave towards you!

Glossary of terms

In the course of being involved in your family business you may come across one or more of the following terms.

accounting reference date – the date registered with the Registrar of Companies as being the date to which the company's annual accounts will be made up – i.e. the last day of the accounting reference period

accounting reference period – the period for which the company makes up its annual financial accounts

allotted – shares are allotted when a person acquires the unconditional right to be included in the company's register of members in respect of those shares

alternate director – a person (normally another director or someone approved by the board of directors) appointed by a director to attend board meetings when he or she is not present

annual general meeting (AGM) – the AGM of shareholders normally deals with the matters referred to in Section 2 of this guide (see "Shareholders' meetings and resolutions" on page 20)

annual return – the return which has to be made annually to the Registrar of Companies containing information about the company's capital and shares, together with a list of directors and shareholders and certain other information

auditors' report – the report to the company's shareholders by its auditors concerning the annual accounts

bonus issue – an offer of new shares to existing shareholders in proportion to their existing holdings and involving a capitalisation of reserves of the company by the issue of shares on a fully paid basis. It is sometimes referred to as a scrip or capitalisation issue

call option – a right given by A to B entitling B to call upon A to sell B an asset (e.g. shares) on agreed terms

charge – a form of security for a loan over an asset or assets of the borrower. The charge document typically gives the lender the right in certain events, such

as default in repaying the loan or the insolvency of the borrower, to use the assets and their proceeds of sale to discharge the borrower's debt to the lender

class meeting – a meeting of shareholders holding a particular class of shares (for example, preference shares)

convertible preference shares – preference shares that carry a right to convert into ordinary shares, either at a fixed conversion rate or by reference to a formula related to the financial performance of the company or its net worth

cumulative preference shares – shares that are cumulative as to dividend – i.e. any arrears of dividend will be accumulated and become payable on the next due date for dividend payment

debenture – a security granted by the company, normally consisting of a fixed charge over certain assets and a floating charge over the other assets

directors' report – the report from the directors that forms part of the annual accounts of the company and contains a report on the company's principal activities during the year, the amount of any dividend recommended, a business review and certain other information required to be disclosed by company law

dividend – a distribution of the company's profits to the shareholders in proportion to their shareholdings

dividend in specie – the distribution by the company of a non-cash asset to one or more of its shareholders

employee benefit trust – a trust established by the company to which the company gifts or loans money, which is then used to acquire shares. The trustees then distribute the shares to employees or directors in accordance with the terms of a share option or long-term incentive scheme

fixed charge – a charge (see above) that attaches to specified assets of the borrower and under which the lender controls any sale or other dealings by the borrower of or with those assets

floating charge – a charge (see above) that "hovers" over specified assets of a company (the borrower). The charged assets can be bought and sold by the company until certain default or similar events happen that "crystallise" the charge. At this point it attaches to the assets and becomes a fixed charge (see above)

general meeting – a meeting of the shareholders convened to deal with any matters requiring shareholder approval that are not dealt with at the AGM

holding company – a company that effectively controls another company (the subsidiary)

interim dividend – a dividend that is declared before the company's earnings for the financial year have been calculated

issued – shares are issued when the entire process of application, allotment and registration has been completed

ordinary resolution – a resolution passed by a simple majority of the shareholders

participating preference shares – shares that entitle the holder to participate in surplus profits of the company and/or in surplus assets of the company on liquidation

partly paid shares – shares that have only been partly paid as to their nominal value – e.g. a £1 share on which only 50p has been paid. The unpaid amount will become due when a "call" is made by the directors in accordance with the articles of association

phantom share option scheme – a cash bonus scheme under which the amount payable to an employee or director is dependent on the increase in the company's share price

poll – resolutions put to the shareholders are normally decided on a show of hands (on the basis of one vote per member). However, a poll can be demanded by certain specified persons authorised to demand it. The poll is taken as directed by the chairman and on any such poll every shareholder has one vote for each share of which he or she is the holder. It is normally used where it is not possible to obtain a clear result by a show of hands

pre-emption rights – the right of existing shareholders to have first refusal on the issue of new shares (normally in proportion to their existing holdings) so as to protect them against dilution of their holdings. Alternatively, the right of a shareholder to purchase some of the shares of a selling shareholder (again normally in proportion to his or her existing holding) before such shares are offered to third parties

preference shares – shares that have limited voting rights but which rank ahead of the ordinary shares as to dividends or capital or both. They normally carry the right to a fixed dividend

proxy – the person appointed by a shareholder to vote on his or her behalf at a shareholders' or general meeting

put option – a right granted by A to B, entitling B to require A to buy all or some of B's assets (e.g. shares) on agreed terms

quorum – the minimum number of directors or shareholders who must be present to enable a valid board or shareholders' meeting, respectively, to be held

registered office – the address that is registered with the Registrar of Companies as the company's registered office and to which communications from the Registrar of Companies and HMRC will be sent and at which legal proceedings will be served. The company does not have to maintain a physical presence at the registered office

register of members – the register forming part of the statutory books of the company, which contains details of the shareholders of the company

retirement by rotation – the procedure, which may or may not be contained in the articles of association, whereby a proportion of the directors retire at each AGM (but are eligible for re-election), those retiring being the longest in office since their last appointment or election

return of allotment – the form that is filed with the Registrar of Companies when new shares in the company are allotted

rights issue – an offer of new shares made to existing shareholders in proportion to their existing holdings, the shares being subscribed for in cash, often at a discount to the market price

shadow director – a person who has not been formally appointed as a director but who is a person in accordance with whose directions or instructions the directors are accustomed to act. Shadow directors can commit certain offences under company law in the same way as directors can

share buy-back – the process by which the company itself purchases shares from one or more of the shareholders, as a result of which the shares so bought are cancelled

share option scheme – a scheme under which directors or employees are granted options to purchase shares in the company, usually at a price equal to the market value of the shares when the option is granted. Some share option schemes are approved by HMRC, which enables those participating in the scheme to benefit from certain tax advantages in respect of their options

share premium – the amount paid for a share in excess of its par or nominal value

special resolution – a resolution passed by a majority of not less than 75% of the shareholders

statutory books – the books of the company containing certain statutory registers such as the registers of members, transfers, directors and directors' interests

stock transfer form – the form used to transfer shares from one shareholder to another

subsidiary – a company that is a subsidiary (direct or indirect) of a holding company (as defined above)

Takeover Code – The *City Code on Takeovers and Mergers* administered by the Panel on Takeovers and Mergers, which regulates offers for public companies (including unlisted public companies)

written resolution – a resolution signed by the directors or the shareholders (as the case may be) and which is as valid as if passed at a directors' or shareholders' meeting, respectively (see further, Section 2 on "Written resolutions", page 22, and "Board meetings and resolutions", page 33).

Published by the IFB Research Foundation

Institute for Family Business (UK)
32 Buckingham Palace Road
London SW1W 0RE

Tel: 020 7630 6250
Fax: 020 7630 6251

www.ifb.org.uk

This booklet is written as a general guide and should not be regarded as a substitute for taking professional advice. While every effort has been made to ensure the accuracy of this guide, neither the author nor the Institute for Family Business accept any responsibility for any loss caused to any person as a result of acting or refraining from acting in reliance on any statement or opinion contained in this publication. You are advised to obtain specific professional advice before taking any action. Any references to the law are to legislation as at 1 December 2008.

Copyright © 2009 Andrew Drake

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means (photocopying, electronic, mechanical, recording or otherwise), without the prior written permission of both the copyright owner and the publisher.

British Library Cataloguing in Publication Data available

ISBN: 978-0-9551898-6-9

Design by The Communication Solution Limited
Printed and bound in the UK by Linney Group
Cartoons reproduced with kind permission of King Features Syndicate, USA.

“All the information that nobody in a family business ever tells you. Invaluable.”

Simon Berry, Chairman, Berry Bros & Rudd Limited

There is a tendency in many family businesses for the next generation to “drift” into the business, whether as owners, beneficiaries of a family trust or as employees or directors. The older generation may never explain to them what their involvement in the business means.

This guide will help the next generation to understand something about their rights, duties and responsibilities and about how family businesses are typically run.

Institute for Family Business
32 Buckingham Palace Road
London SW1W 0RE
Tel **020 7630 6250**
Fax **020 7630 6251**
www.ifb.org.uk

ISBN 978-0-9551898-6-9

£9.95