NEWSLETTER

NAVIGATING FAIRNESS IN A FAMILY BUSINESS

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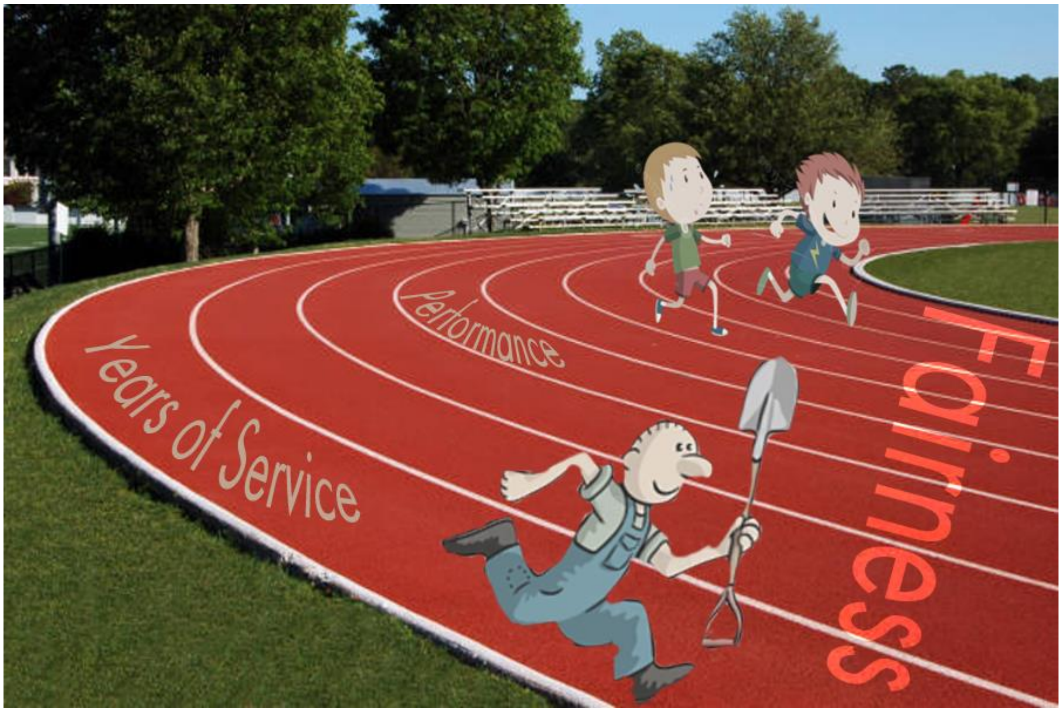
André Diederichs



IMAGINE a family business where harmony resonates through every interaction and every decision made, as if each family member is a musical note in a beautiful melody that blends seamlessly to create perfect harmony.

Where it is not just about the success of the business, but also about the family bonds that tie us together. It is a tapestry of love, trust, and shared dreams.

COMPARE this with a family business where every morning feels like a battlefield where distrust lingers in the air, poisoning our relationships and corroding the bonds that once held us together. We once believed in the promise of fairness and opportunity, but now the pervasive sense of unfairness leaves us feeling powerless and alone.

NAVIGATING FAIRNESS IN A FAMILY BUSINESS

Navigating fairness among children in a family business can indeed be a complex issue. Children may have different years of service or levels of involvement, which can make it challenging to ensure family members are rewarded fairly.

Some parents decide to treat all children equally in a family business, regardless of their involvement or contributions.

It may seem fair on the surface, but it can lead to issues of unreasonableness and resentment, both within the family and the business itself.

Observations as a Family Business Consultant:

Decades of experience, with over 500 consultations and many mediations, have taught me how the emotional burden of constantly striving to be fair can weigh heavily on parents.

As a parent myself, I understand why parents may feel emotionally drained from trying to navigate the complexities of family dynamics and meet the diverse needs of each child.

Balancing fairness with other priorities, such as the sustainability of the family business, can create a conflict of interest for parents. They may struggle to reconcile competing demands and obligations, leading to feelings of frustration or helplessness.

As a family business consultant, I have to guide parents to balance their long-term vision for the family business with the immediate impact of their decisions on their children's lives and career paths. They often grapple with the trade-offs between short-term comfort, by trying to keep each child happy, and to ensure long-term growth and sustainability of the family business.

Navigating these conflicting thoughts and emotions requires careful consideration.

A **FAMILY BUSINESS CONSTITUTION** is an ideal tool to ensure open communication and to focus on the best interests of both the family and the business.

It fosters healthy sibling relationships and maintains transparency in decision-making processes that help parents make informed choices that balance both family and business needs.

TYPICAL OPTIONS TO DISTRIBUTE WEALTH

Fairness in a family business is divided into two categories, namely Ownership and Remuneration (Compensation)

1. Typical Ownership Options:

Assets remain in a Family Trust: Children and their natural descendants are simply beneficiaries in the Family Trust that is managed by trustees and beneficiaries do not have vested rights. The Trust Deed dictates the discretionary powers of the trustees.

Simple equality: Assets are divided equally amongst children, irrespective of the personal contribution of family members to the business, via shareholding or as equal beneficiaries in a Family Trust/s.

Asset distribution according to contribution: Only the children who are actively involved receive business assets via shareholding or as beneficiaries in a Family Trust/s.

NOTES

***Should you want a specific beneficiary to be favoured over others in a discretionary trust, one can state that in the trust deed – otherwise, beneficiaries may put pressure on trustees to treat them equally. For detail read*:** https://trusteeze.co.za/article/can-one-distinguish-between-beneficiaries-in-a-trust-deed

Best practice dictates that the shareholding in the operating company/s should be owned by the family trust/s to avoid estate duty and transfer costs.

Is equality fair?

Decades of experience have taught me that equality is not necessarily fair. Typical examples I dealt with over the last year are:

1. A sixty-two-year-old farmer from the Northern Cape has been farming with his dad for over 40 years while his brother established a successful engineering company in Gauteng and became wealthy on his own. The 84-year-old father believes that children should be treated

equally and now wants to split the farm equally (50%) between the two brothers. IS THIS FAIR?

2. Two brothers and a sister are involved in a family business in a neighbouring country. Both the brothers were involved from the start of the business. They both received 24% of the shares. Some years ago, their father died and their mother inherited his 24% shareholding which gives her 48%. The remaining 4% belongs to the daughter. The mother wants to retire soon and she now wants to give 20% of her shares to the sister to make her shareholding the same as the brothers.

The brothers are upset because she only joined the family business 12 years after they started the business. IS THIS FAIR?

3. Two brothers and a sister are beneficiaries in a Family Trust. Only one brother kept on farming with his mother after their father died while the other brother and sister followed other careers. The two siblings who are not involved in the farm want to "sell" their share as beneficiaries and demand that the net value of the farm be equally split among the three children. The brother who kept on farming cannot afford to pay 2/3rds to his brother and sister and might even have to sell the farm if he is forced to pay his siblings. IS THIS FAIR?

NOTE

Best Practice dictates that equality is not always fair

While equal treatment for all children in terms of ownership may seem fair on the surface, it's essential to consider whether it truly reflects the value and contributions of each individual.

Implementing a merit-based approach to ownership can help ensure that rewards are distributed fairly, based on each child's involvement, performance, and contribution to the business.

Sweat Equity

Acknowledging Sweat Equity is a crucial factor in determining inheritance within a family business. Recognising and rewarding long-term-dedication and commitment can foster a sense of fairness and loyalty among family members involved in the business.

Children who have devoted significant time and effort to the success of the business should be appropriately acknowledged and rewarded in inheritance arrangements.

This acknowledgement can help maintain harmony within the family and ensure the continuity of the family business by incentivising ongoing commitment and engagement from family members.

It is also important to keep in mind that younger family members may demonstrate exceptional performance and contribute significantly to the success and growth of the family business

It is essential to recognise and reward performance and contribution rather than solely basing shareholding on seniority or years of service in a family business.

NOTES

A typical practice is to distribute assets outside the family business to children who are not involved in the family business, such as life insurance or other assets, e.g. property that is not established in the family business

2. Remuneration options for children who are involved

Equal remuneration for family members in a family business, irrespective of individual contributions, may not always be fair or sustainable in the long term.

Here are some reasons why:

Equal remuneration regardless of individual contributions can lead to a lack of incentive for family members to perform at their best. If someone knows they will receive the same compensation regardless of their effort or performance, they may not be motivated to excel or contribute their full potential to the business. **Remember: Rewards Drive Behaviour.**

Equal remuneration may be unfair to family members who contribute more or perform better than others. High-performing individuals may feel undervalued and demotivated if their efforts are not recognised and rewarded appropriately.

The Best Practice is to create **Performance Contracts** for each family member that clearly outline their **Key Responsibilities** and **Clear Measurements** of how they perform against those responsibilities.

This allows a merit-based approach to remuneration that aligns compensation with individual contributions, skills, and performance. It fosters a winning culture within the family business.

Equal remuneration regardless of performance can undermine this principle and create resentment among family members who feel that their efforts are not being recognised or rewarded fairly.

Another approach is to measure **ROI (Return on Investment)** against the profitability of each family member.

The main aim of a business is to maximise profit. If a family member is measured against his/her profitability they will not only aim to maximise the income of the family business but they will also be weary of unnecessary expenses. **This is a magic formula for success.**

EXAMPLE

A Family Farming Business diversified its operations between Grain and Livestock. One child manages the Grain and the other child manages the Livestock.

Determine the profitability of each child as follows:

1. Determine the **net profit** of the specific operation

2. Determine the **child's cost to the family business** (e.g. direct financial remuneration [salary, bonuses], free diesel, free mobile phone, free accommodation etc.)

3. **Apply this formula:**

Net Profit ÷ Child's cost to company x 100 = %.

The higher the percentage (%), the more profitable the ROI.

Advantages or ROI are:

It allows you to assess the efficiency and effectiveness of each person's contributions to the business.

It also helps to make informed decisions about resource allocation within the business.

Linking ROI to profitability aligns family members closer to the overall goals and objectives of the business.

Evaluating ROI against profitability promotes fairness and accountability within the family business.

Monitoring ROI against profitability also allows you to measure performance over time and identify opportunities for continuous improvement.

To effectively determine ROI against profitability for each family member in a family business, consider the following steps:

- Define clear metrics and key performance indicators (KPIs) that align with the goals and objectives of the business.

- Track and measure the ROI of each family member's contributions using relevant performance metrics and financial data.

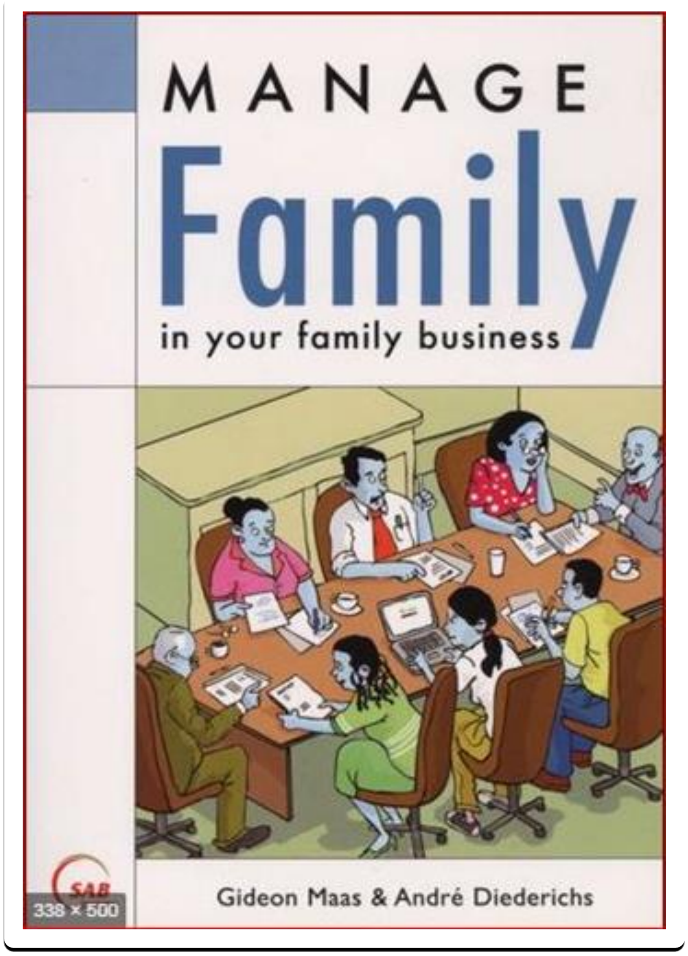
- Analyse the relationship between individual ROI and the overall profitability of the business to identify areas of strength and opportunities for improvement.

- Provide feedback and support to family members based on their performance evaluations, highlighting areas of success and areas for development.

- Use performance evaluations to make decisions related to compensation, promotions, and resource allocation within the business.

CONCLUDING REMARK

A lesson has the irritating manner to repeat itself until we learn and apply the lesson. Something that is not fair has the same effect. If something is not fair it will not disappear but simply resurface. As the wise Afrikaans Poet C.J. Langenhoven rightly stated (loosely translated): *Nothing is ever final that is not fairly settled*



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CALL TO ACTION

To enhance objectivity, you can contact us to assist you in determining quantitative & qualitative criteria and weightings for each criterion.

Another sound route to follow is to compile a Professional Family Business Constitution and Succession Plan

For assistance contact us via email at: info@fabasa.co.za ***OR via WhatsApp on mobile number: 082 453 3288***