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What type of owners do you want?

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Ownership policies in a family business need to reflect the family's attitudes in relation to the following.

1. Are we value-out owners or custodians?
2. Should ownership be restricted to bloodline or include spouses and partners?
3. Should ownership be restricted to those who work in the business?

Value out or custodians

Value out owners expect a market rate of return and if this is not achieved then, like any rational investor, they will want to sell their stake and invest in something else.

Custodians, on the other hand, attribute value to returns that are not based on immediate financial reward, or they measure return over a longer period. For example, the custodian may want to create or maintain a legacy of family ownership to pass to the next generation or look after the interests of other stakeholders, like employees. These returns on investment make sense to a custodian even if they incur a financial cost, but they would make little sense to a value out owner.

This matters because the different attitudes must be reflected in the policies governing sale of shares.

- Value-out owners will expect to be able to sell when they want and receive full market value. In a company whose shares are not traded this might involve revaluing assets to reflect market rather than book value and never discounting the share value even if the owner has a minority stake.
- None of this will make sense to a custodian who assumes that there will be a limited opportunity to sell shares and the share valuation will be less than the market value because sale goes against the grain of a custodian mentality.

Differences also arise in relation to dividends.

Value out owner	**Custodian / steward**
Expects a market rate of return	What can the business afford?
Uses distributable reserves if annual profits are low	Based on annual profits
Borrow to fund dividend payments	Pay from positive cash flow

Bloodline or spouses?

Those in favour of spouses and partners becoming owners would argue the following points.

a) Ownership provides financial security for a spouse, especially when this represents a significant part of the family's wealth.

b) Transfer of ownership to spouses creates opportunities for more tax efficient planning.

c) Spouses diversify and strengthen the ownership base.

d) Including them communicates a strong signal about being part of the family and the business.

e) As parents of the next generation, spouses are more likely to pass on positive messages about the business if they are owners.

f) In the event of relationship breakdown, a spouse should automatically transfer their ownership back to the bloodline family member.

Those in favour of limiting ownership to bloodline family members would retort as follows.

a) Ownership might provide a relatively modest return, especially if there is a custodian attitude to ownership.

b) There are alternative ways to protect the financial security of spouses, for example life insurance.

c) Transfers to spouses creates more minority interests for the company to manage.

d) Spouses could dilute the sense of familiness rather than strengthen it.

e) Inclusion can be addressed through spouses being involved in other aspects of governance, such as a family council.

f) Family tension may be caused if some family members transfer ownership to their respective spouses while others do not.

g) In the event of relationship breakdown there will always be scope for dispute over valuation and the provisions requiring transferring shares back to the bloodline.

Working and non-working owners

Some families believe that owners should work in the business because this will avoid conflict with non-working relatives who are not contributing to the business by the sweat of their brows.

This attitude can have unintended consequences. Family members who pursue other careers and are cut out of ownership may feel they are also being cut off from the family, especially if the business represents a significant portion of the family's wealth.

Alternatively, they might decide to take a career in the family business, and then resent it because they feel they have been forced to sacrifice their own career aspirations to become a shareholder.

Some family businesses use different classes of shares to distinguish between working and non-working owners. Generally, these give working owners voting control while non-working owners are entitled only to economic returns. This raises interesting challenges.

- What happens when either a working owner leaves the business or a relative joins the business? Do the former have to sell their stake or does their ownership become non-voting, and how do the new joiners acquire ownership?

- Who is to guarantee that the most talented family members are working in the business and are most capable of exercising the responsibilities of ownership?

Blending attitudes

It is important to be aware of the pros and cons of these different ownership attitudes. Presenting them as if you are either one or the other is artificial because often families combine different attitudes, for example,

- 'We favour custodian more than value-out but we still want a dividend.'
- 'Generally we favour working owners but exceptions can be made'.
- 'My spouse can own shares but this will not apply in later generations.'

However, presenting the alternatives in this manner will help a family make choices and assist their advisers in developing policies that reflect the family's unique alloy of attitudes.

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