THE VALUE IN LEGISLATING FOR FAMILY BUSINESSES
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Europe has a rich history of family businesses and many of the world's best known family businesses are based in the region. They have been highly influential not just in Europe's economic development, but also, in many cases, in its social development. If the ancient Egyptians are considered the first example of sophisticated civilization on Earth, then it could be said that family businesses may well have their origins in the Middle East. From a European perspective, Europe has some of the oldest family businesses in the world dating back to the year 1000 and in some instances still in existence. If we glance over at the English Monarchy we understand how that kind of joint family standing, a combination of business and land ownership creates a brand and regime in itself. The British monarchy or Family Firm as Prince Phillip once referred to it can teach us a few things about business and about the importance of governance and succession. The Royal Family is certainly not the only European family with a rich history. Many of the world's best-known family businesses are based in this continent. They have been highly influential, not just in Europe's economic development, but in its social development too. Today many of the merging family businesses can be particularly seen in Eastern Europe.

On a global level, of the world's 250 largest family businesses, a third are located in Europe. In fact, 85% of the companies in Europe are family-owned. Probably the two biggest are Volkswagen and the Italian investment company, EXOR, owned by the Agnelli family. Together, the family businesses of Europe employ a staggering 144 million people. If we look at North America, the figure is even higher whereby 90% of companies there are family-owned. To this end, one of the great success stories of modern times and a hallmark of the American dream is Walmart. It was just over 50 years ago that Sam Walton opened his first discount store in Arkansas. Walmart has grown and grown but it is still owned by the Walton family. Today it operates in 27 countries and, according to the Fortune Global Five Hundred list, Walmart is the world's largest company by revenue. It is worth pointing out that many of the privately held family businesses in the United States and Canada are in their second generation of family ownership or beyond, which has to be testament to the resilience of this type of business.

Looking around the globe, 90% of the companies in the Middle East are family-owned businesses. They control virtually all of the oil producing companies operating in the Gulf. 85% of the companies in Asia-Pacific are family owned, and in Australia the figure is 71%.

One thing that seems to be true the world over is that family-run businesses don't blow their own trumpets. They are as unlikely to sing their praises publicly as they are to complain too much when the going is tough. They are very private and don't like to draw attention to themselves.

Multigenerational family operations, sometimes with centuries of commercial nous, are more prone to ride out the storms than to express too much dissatisfaction about the current state of affairs. But as governments around the world oscillate on which fiscal policies to follow and businesses struggle under the weight of unwieldy regulation and inefficient tax codes, family businesses are becoming more vocal.

Some Australian family businesses have publicly said that their government is not giving enough support and is failing to differentiate between family firms and small-to-medium enterprises. This is despite the fact that some of the country's biggest companies, such as Westfield chain of shopping centres and the mining giant Hancock Prospecting are family owned.

Last year the Family Business Australia organisation produced a report to government entitled "Family Businesses in Australia – Different and Significant: Why they shouldn't be overlooked." One of the most promising recommendations of their report was that a legal definition of family businesses be established. Should this happen it could signal that the Australian government was considering family firms more carefully in its policymaking. The report asked the government to gather comprehensive data on family firms and assess how legislation might affect family firms differently to other types of companies.

As an offshoot from this we see that family businesses are also formalising their governance structure more than before. Family councils and charters, business charters and advisory boards are all attracting more attention. Family businesses that continue to prosper from one generation to the next often do so because they have robust governance structures. Nevertheless, many family businesses have not given enough thought to governance. They rely too much on a carefree attitude toward issues such as succession, ownership and management, and they wait until one of these issues becomes an unavoidable problem before attempting to deal with it. Often, that is too late, and the business will suffer as a result.

Some of the more common governance problems that can arise within family businesses are:

Succession and dependence on its owner;
An unwillingness to relinquish control when it would benefit the business to do so;
Internal family conflicts;
The assets of a business being abused by family members for their own personal benefit;
Nepotism, and discouraging non-family business staff;
Tunneling – a situation in which family owners create a complex set of ownership structures that undermine non-family minority shareholders. This can ultimately damage the efficiency of the business.

Other concerns are:

Who can or cannot be a shareholder;
What are the different classes of shares;
How are the owners to be represented on the board;
How will the owners set objectives and challenge management;
What are the important issues on which the management should consult the owners;
What are the rules on exits for shareholders, and so on.

It is an interesting observation that those operating in consumer markets often promote themselves as family businesses but this is rarely the case in other types of industry, such as engineering or construction. Some observers point out that as countries emerge from recession, the aura of stability and continuity associated with family ownership is just the sort of thing to inspire confidence and fill order books.

Although family participation is critical for business growth, the family structure itself weakens as companies enter their third or fourth generation. This, of course, hampers growth. In generation one, the owner manages the company. In generation two it is largely the sons and daughters. In the third generation, it gets complicated.

Often the challenges posed by 'family expansion' are exacerbated by the fact that family constitutions are rare. A family constitution is an especially sensitive issue in second or third generation families where the founder is still alive and succession is an issue and as a result many families have informal verbal codes or understandings that guide their businesses.

Even in families with a constitution, if the founder of the business still holds power, the constitution is often ignored when it contradicts the will of the dominant member of the family. Such lack of institutionalisation can make the family business an unattractive option for the next generation. In the third generation, you see people moving away and starting their own companies.

But a number of families are finding ways to address the issue of youth flight: some companies are using stock offerings as a way to reorganise power and wealth across a growing family empire. In fact, listing on a stock exchange would give some of the third generation the option of cashing out.

With wealth management and formal governance mechanisms not yet fully entrenched as practices among the business elite, it should come as little surprise that the family office structure has not taken hold. More telling than the fact that many family businesses do not have a family office is the fact that more than a third of them have never heard of a family office.

Family offices face several challenges as much of the wealth is new in Malta, and many first and second generation wealth builders remain focused more on developing their businesses than preserving their wealth. Unsurprisingly, the proportion of third and fourth generation family members, or the next generation as we label them willing to consider establishing a single or multifamily office is far greater than the cross generational average. The next generation's openness to family offices might be connected to their greater use of wealth management services. Almost two thirds of next generation participants use wealth management services frequently or occasionally, much more than the overall participant average of about 50%.

While trust is an important factor across generations when selecting wealth managers, the next generation gives 'investment track record' equal importance, twice the rate attributed by earlier generations. Coupled with higher rates of educational achievement, as well as international travel experience the next generation of wealth builders appear to be primed to adopt more sophisticated business and wealth management mechanisms.

Many next generation wealth builders identify the need for more formal structures in organising family wealth. Whereas on average only half of all family businesses adhere to a corporate code or plan to implement one, almost all third and fourth generation wealth builders have implemented a corporate code into their business.

The third generation wants formal arrangement and protocols. They understand the changes brought about by globalisation and they are looking abroad for inspiration. They don't want narrow, conservative companies. These younger family members are taking a step toward family offices by trying to motivate their financial service providers and trusted family lawyers to establish structures to provide some of the services of a family office.

From a legal business model perspective, purpose trusts, private trust companies, family partnerships, limited liability partnerships and protected cell companies generally provide the building blocks for family holding structures, but competition among jurisdictions is intensifying. As a result many are expanding or upgrading their legislative arsenal to cater specifically for high net worth families and this is currently one of the most innovative areas of offshore legislation.

Hong Kong has just followed Singapore by modernising its trust laws, while Guernsey, Jersey and the Isle of Man have all introduced foundations to broaden the fiduciary options to civil law jurisdictions. The Bahamas Executive Entity was introduced specifically to control and protect decision-making at the top level of a structure. It is also interesting to see that Luxembourg and Qatar have followed Dubai by introducing a specific regulatory framework for family office activities.

Dubai has introduced the legislation on the Single Family Office Regulations which specifically addresses the needs of family-run institutions and governs the registration procedure and documentary requirements for a single family office.

The regulations offer distinct benefits to single family office by excluding them from many of the regulatory restraints placed on conventional financial institutions of the Dubai International Financial Centre. This is on the basis that single family offices have no direct public liability.

A single family office may be incorporated or established as a body corporate or a partnership for the purpose of providing services to a single family. It must comprise either one individual or a group of individuals who are the bloodline descendants or a common ancestor and must own a minimum of $10 million in investable or liquid assets.

In 2012 Luxembourg introduced a specific regulatory framework for family office activities under the Family Office Act. This states that family office activities consist in providing, on a professional level, patrimonial-related advice or services to private individuals, families or patrimonial entities founded or owned by, or benefitting, private individuals or families. A draft law that was submitted to Luxembourg's parliament in July last year is addressing the lack of legislation around foundations. The new orphan tax structure "foundation patrimonial" have no members, shareholders or associates and is aimed at broadening the range of investment vehicles for high net worth individuals in Luxembourg.

So, where are we now?

Confidence in market conditions among the family business community is clearly on the rise and visible from survey results. This year, more respondents have been willing to state their view as positive, as opposed to neutral, and for this market segment, all the signs point to market confidence returning even with a war on talent playing out in the background.

There are many reasons for increased confidence not least the changing funding landscape. Access to finance and credit is no longer as big a concern as it was six months ago. A willingness to re-invest profit and the ability to secure bank funding is on the rise.

Understandably, we should recognise that while access to finance is improving, it is not the same experience for everyone. For some family businesses it is still a struggle.

In drawing up legislation for family businesses, observing what the European Union has to say on business transfers is elementary. To this end, the European Union has campaigned to encourage the creation of legislation and a framework of transfer-friendly regulation. And, of course, it all begins with money. The European Commission recognises that buying an existing business often requires more capital than starting up a new business. Assisted loans, guarantees and forms of equity capital for a limited period could make it easier for a larger number of potential transferees to take over businesses.

Then there's the creation of business advisory services. As business transfers touch upon complex problems such as succession legislation, taxation, preparing the company for sale, price evaluation, etc., advice from specialists such as business consultants, tax auditors, lawyers, accountants, banks and notaries is needed to carry out the process.

Training is important for increasing entrepreneurs' knowledge of business transfers and their readiness to carry one out. Specific training courses on business transfers for both transferors and successors will provide the entrepreneurs with the knowledge and tools to plan to carry out the transfer process. These and others are an indication of suggestions from the European Commission which are being taken onboard as the legislation is developed.

To date no other member state has formally recognised in standalone legislation the transfer of a family owned and run business to the next generation, as we in Malta are proposing. There is a soft reference in some jurisdictions, references are made to family members but none define family business or formally assist in the transfer from one generation to the next – the hinge which matters most. The scope of this unique legislation is to assist and facilitate the transfer and ownership of the family business from one generation to the next without hindering the continuity and development of the business. It is imperative that development is encouraged and equally vital that there is continuity in the event of the owner's or an associate's death. Legal restructuring must be given a smooth path, in order to avoid liquidation.

Financing is, obviously, another important aspect. Guarantees for equity or quasi equity fund investments in SMEs should include investments by local or regional funds which provide seed capital and/or capital in the start up phase, as well as mezzanine finance, in order to reduce the difficulties which SMEs face due to their financial structure, and those arising from business transfers.

Operating such an innovative structure entails significant costs both from a human resource, physical resources and capacity building perspective. A regulator or manager will coordinate and administer the legislation, its functions and duties.

One of the functions that the legislation needs to provide is for a central reference point that will be raising awareness because one cause of major problems in business transfers is that the planning for the process starts too late. Raising awareness about the need to prepare for the transfer a long time in advance is the starting point for a successful transfer.

The Family Business Act will be distinctive not only in its legislative scope and intention but unique to the legal community on a European and International level. While this allows for a wide vision, the disadvantage lies in the fact that accurate and tangible research, statistics and data are either negligible, non existence or irrelevant. Research, statistics and data need to be gathered not only at inception but also during the operational stage to monitor the growth, success, or failure of the legislation. To this end, the initiation and start-up depend entirely on financial assistance from the government. The beneficiaries of this legislation will be nationwide because nearly the entire business community could potentially be eligible to benefit from this legislation. In addition, we must recognise that foreign family businesses, who opt to register their business in Malta, will also become valid beneficiaries.

Whilst this legislation is commendable for spearheading ahead in bringing together the cry from the European Commission, family businesses and government policy, this legislation and its success must be seen as a marathon not a sprint, whereby its true test of success will be calibrated in the generations to come.