

Family Firms May Need More Legal Advice Than They Think

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KEYWORDS: Family Business Consulting, Family Business Review, family business advice, Running a family business tips, family business conflict.

Families are often reluctant to anticipate and plan for the day when an unexpected transition might upend their business. The costs of inaction are high.

EDITOR'S NOTE: This article was produced in partnership with Family Business Review, a leading journal in the field of family business, as part of FamilyBusiness.org's mission to bring research-proven insights and practical advice to our readers.

Family business owners often depend on legal advice to control ownership changes and uphold a functional balance between owners. This legal advice on ownership issues spans both family law and business law. Properly done, it creates contracts that protect the family's interests during painful and/or emotional transitions such as death, conflict or divorce.

However, our research showed that family business owners often underutilize the legal instruments available, either because they are afraid to contemplate unpleasant matters or they think one type of advisor can help them with all types of problems. Our research focused on exploring the market for legal advice provided to family business owners specifically about contractual ownership regulation to find out two things:

- Why is family business ownership insufficiently regulated by contracts?
- What factors impede the market for legal advice to family businesses and their owners?

What We Studied

Contractual regulation is needed to avoid unwanted transfers of shares, along with other problems. The death of a shareholder can cause such transfers and could jeopardize the operation of the business or the possibility of a future succession within the family. From our prior studies, we know that family business owners insufficiently use the tools available to regulate their ownership (such as shareholders' agreements, articles of association, marital agreements, and testaments) and hesitate to contact legal advisors. This made us curious to figure out why.

Our work, which focused on Scandinavia, explored the types of legal advice available to family business owners on ownership regulation. Such regulation partly comes in the form of default company law, but more importantly, we study how families use contracts to tailor the regulation to the owners' situation and specific needs. We studied advice on business law instruments (shareholders' agreements and articles of association) and family law instruments (marital agreements and testaments). Working with a team of researchers from both business administration and law, we conducted in-depth interviews with 30 legal advisors and nine owners of small and medium-sized companies. In addition, we collected 105 online survey responses to further capture the owners' perspectives.

What We Found

Our findings showed that family business owners in most cases receive only partial advice, primarily covering either business law or family law. At best, owners seek legal advice from one advisor, typically a business law advisor, when they really need to consult several types of advisors, leading to an unfortunate neglect of family law. This finding led us to dig deeper into why this happens. The problems occur both on the

supply side, caused by the nature of the market for legal advice, and on the demand side, caused by the behavior of family business owners as customers of legal advice.

On the supply side of the market, legal advisors are highly specialized content advisors. They are typically trained in one legal specialty. The specialization is rooted in the profession and connected to professional identity and prestige. Even when individual advisors perform their jobs well, you often need to consult more than one advisor to all the advice you need. For instance, many law firms are specialized, and staffed with either business law lawyers or family law lawyers. But to our surprise, there is a lack of coordination between specialists. As a business law advisor explained to us:

“One should probably tell them to look over their private legal situation with a relevant lawyer. I would recommend that. But to be honest, you would seldom think about it because you are primarily focused on doing your own job.”

On the demand side of the market, we find that family business owners generally are no legal experts. Quite commonly, business owners have been told that they need legal advice from their accountant, bank, business advisor, or business associates, but they do not know which kind of advice or contractual regulation they need. Owners also hesitate to spend time and money on legal services.

In addition, ownership regulation raises sensitive issues -- for example, conflicts, divorce, or death of a family member. Testaments and marital agreements remind people of their mortality and the risk of marriage failure. Planning for ownership succession forces families to contemplate difficult decisions, such as the division of roles and responsibilities among siblings. Even raising these issues can cause conflicts that family business owners would rather avoid, so they don't dare to address these questions.

While fees for legal advice is a predictable impeding factor, how the emotional strains affect the market for legal advice have not been elaborated on before. As one family law advisor told us:

“There are a lot of emotions in this, clearly. Not fun to be newly married or just invested money in a business and think about the day you will die. Or if you get a

stroke, or if the wife will leave you.”

The family business owners whom we interviewed confirmed that instruments regulating family law issues feel sensitive to raise, causing emotional strain. As one owner told us:

“It raises issues of what may be. Like, suddenly you say to your partner ‘you will never be part of this, as long as we are together you will benefit, we will have dividends, but you will never ever own anything.’ And you have to have the courage to make this decision. It can be tough.”

Takeaways

Our study shows that the market for legal advice is fragmented, and no one agency can fill all the needs of family business owners. Improved market coordination coupled with raised customer awareness is needed.

Adjusting the Market

Our findings show that there is great room for improvement in the market, and opportunities for legal advisors who can give family business owners holistic advice on regulating ownership change. Ideally, a collaborative team of legal, financial, and relationship specialists should work together to provide this advice, which should incorporate both business law and family law. But our study shows that legal advisors often don't coordinate with one another. Legal advisors could work in well-integrated cross-disciplinary teams suited to the needs of family businesses. This might sound easy, but in practice our study shows that it doesn't happen. As an alternative, a new type of process advisor could coordinate content experts from separate legal fields and guide the owners through the procedure.

Beyond legal advisors, family business owners often turn to a trusted accountant, bank, or elsewhere for initial advice. These non-legal advisors could help direct families to the right legal specialists so that family business owners get the legal support they really need at key moments.

Increased Awareness Among Owners

Family business owners are known to be protective of their businesses. If they were better informed of the benefits of legal agreements, they would accept the costs entailed, in time, money and emotions. Such costs are relatively small compared to the potentially

devastating costs the measures are intended to prevent. Regulating ownership change is the way for business owners to minimize the future risk of more severe costs that could jeopardize business survival, in cases such as conflicts, divorce, and death. Process advisors could help the family business by raising awareness of these risks.

Considering family businesses' contribution to employment and GDP, it should be in the interest of policymakers to improve owners' awareness. This can be done by providing information and recommendations on official webpages (for example, at the site where family business owners usually seek information on setting up a company, tax, and submitting annual reports). Similarly, legal advisors can develop best practices that better fit the needs of family businesses. They can help families understand the need for formal regulation spanning the two separate frameworks of business law and family law.

If you are part of a business family, think about whether you are prepared for ownership change. Consider what could happen if conflicts arise or if one of the owners dies or divorces. See if you need to make additional preparations -- and make changes well before you may need them. Communication is key: Decide together what fits your family.

Explore the Research

Legal Advisors and Family Business Owners: A Transaction Cost Understanding of the Ownership Contract

(<https://journals.sagepub.com/doi/10.1177/08944865231217882>) , Family Business Review, December 29, 2023