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THE MANY ROLES OF THE FAMILY BUSINESS ADVISER

By necessity, the family business adviser needs to be a jack of all trades – part financial adviser, part estate planner, and part psychologist. Because the adviser will be called upon to help make a wide variety of decisions in advising the family, the adviser needs a unique set of skills. This chapter will discuss the role of the family business adviser and will also provide an introduction to many of the topics covered later in the book. **1.001**

A. CHARACTERISTICS OF A "FAMILY BUSINESS"

Family businesses are an important and vibrant part of the U.S. economy. In fact, depending on the definition of a "family business," such firms may actually comprise the bulk of the wealth in the U.S. This is wealth that will largely be transferred as ownership and control inevitably pass to younger family members. On average, family businesses are more profitable and grow **1.002** faster than their publicly-traded counterparts. Ironically, few of these businesses last more than two generations. Better planning can help reduce this grim figure.

1.003 Although the majority of family businesses are small, with sales of less than $10 million, a number of family businesses are really quite large. In fact, 40 percent of the Fortune 500 firms are either family-owned or "family-controlled."[1] Wal-Mart, controlled by the Walton family, is described as the largest U.S. family business in terms of sales. Other well-known U.S. family-controlled firms include Ford Motors, and Viacom, controlled by the Redstone family. Outside the U.S. many large multinational companies are family-controlled, although outside stockholders own the majority of the stock. In the UK the largest family-controlled may be the Weston family-owned food products company Associated British Foods, while in Canada one of the largest is Thomson-Reuters owned by the Thomson family.

1.004 Fully one-half of the U.S. GNP is generated by family businesses and they employ over one-half of all U.S. workers. Overseas family businesses are also prevalent including large family-controlled firms like Volkswagen, Japan's Suntory Group, Korea's Samsung and India's Tata Group that owns Jaguar Motors. Of course, most large publicly-traded corporations in the U.S. and U.K. started as family-owned enterprises. Some of the twenty-first century's largest corporations will come from the ranks of today's family businesses. Large or small, family businesses experience many of the same issues that set them apart from other businesses. Even though a large business like Viacom is not normally thought of as a "family business," its ownership structure resulted in the same sort of family succession issue that bedevils small family businesses that are just a fraction of Viacom's size.

1 There are a number of readily accessible sources on the size and scope of family businesses. The Family Firm Institute's "Global Data Points" provides an overview of family businesses world-wide. http://www.ffi.org/?page=globaldatapoints. Mass Mutual Insurance's 2007 "Family Business Survey" presents data primarily gathered from owners of medium-sized U.S. family businesses. https://www.massmutual.com/mmfg/pdf/afbs.pdf. The Conway Center for Family Business "Family Business Facts" can be accessed at: http://www.familybusinesscenter.com/resources/family-business-facts/. The page includes links to other family business surveys. The well-researched Laird Norton Tyee Family Business Survey 2007 can be accessed at http://www.familybusinesscenter.com/public/files/resources/laird-norton-tyee-survey-2007.pdf. The Swiss University of St. Gallen's "Global Family Business Index" ranks family businesses world-wide http://www.familybusinessindex.com while PWC's "Great Expectations" PWC 2014 Family Business Survey-Up Close and Professional: The Family Factor can be found at: https://www.pwc.com/gx/en/pwc-family-business-survey/assets/family-business-survey-2014.pdf. PWC's "The Next Generation of Family Business Leaders 2016," focuses on family businesses world-wide and is found at: http://www.pwc.com/gx/en/services/family-business/next-gen-survey.html Other consultancy companies publish and constantly update similar surveys.

Although advisers may be very familiar with their family business clients, it helps to keep in mind the special characteristics that distinguish family firms. Although there is no universally-recognized definition of a "family business," most would agree that they usually share the same two important characteristics: **1.005**

- Family members control ownership of the firm; and
- Family members work together in the company.

It also is important to remember that the owners think of the business not just as a "business" but also as a "family business." Owners of family businesses traditionally have expected to hand the business down through generations. Although most family firms do not enjoy this longevity, several have been in existence for hundreds of years. Some overseas family firms have prospered literally for centuries. Many have shifted direction with changes in the economy and changes in the family. Because of the focus on the family unit, the family business owner's focus and goals are different. These goals are discussed in more detail later in the chapter. **1.006**

1. Corporate culture and family values

Businesses – even in the same industry – do have far different "cultures." One company may favor metal desks and linoleum floors while another provides managers with limousines and catered lunches. One may provide job security for life while another may view layoffs as a regular event in every business year. Family businesses also have "cultures," and it is important for the adviser to recognize them and to appreciate how they shape business decision-making. **1.007**

In the context of a family business, the corporate culture will be strongly shaped by family values. Although these family values are occasionally written up in a family "mission statement," the family's goals and values are often not articulated. However, the goals and family value structure may be implicitly understood by all family members. Family values of loyalty to fellow family members and personal sacrifice are learned early in life. Individuals brought up in families with family businesses normally implicitly understand how family business decisions are made, and the importance of various factors in making those decisions. **1.008**

A family may tolerate a family member-employee who is coasting and not pulling his weight in the business. Although keeping the individual on the job may be a poor business decision, it may be the right family decision, depending on the family's value system. The family may view a job in the **1.009** business as a “birthright” of sort, and all members may implicitly understand that in their family, family membership counts more highly than merit. Other family businesses may be run in a more business-like manner.

2. Profile of the American family business

1.010 Another common characteristic of family businesses is informal management practices. Generally speaking, the larger the business, the more formal its management practices will be. Many profitable family businesses – especially first generation businesses – are operated by entrepreneurs. They may dislike legal niceties and paperwork. Even if the family business is operated as a corporation, the family may be lax about complying with the legal formalities of operations. There may be no formal board of directors’ meetings and certainly no shareholders’ meetings. In fact, there may be no practical reason to have board of directors’ or shareholders’ meetings, although in most states the law does require them to be held unless the corporation has formally opted out.

1.011 Although certain family members hold the traditional titles of CEO, Chief Operating Officer, President or Vice President, the real power structure in the business may not correspond to these titles. In families dominated by an autocratic founder, the founder may have all the power and the officers’ titles may be meaningless. In other companies, the family members may share power in a democratic manner, with each having an equal say in management of the company in spite of their job titles. Employees who are not officers may wield an enormous amount of influence. In a family business, one’s status in the family may count more than one’s title.

1.012 Family businesses also differ from other businesses in the longevity of management. Upper management typically serves for decades, which is in sharp contrast to other businesses in which most managers shift between firms in their careers. Family business culture explains the difference. A family member working in the family business typically makes a long-term, and in many cases a life-long commitment to work in the business. Likewise, the expectation is often that the family member can work in the business for as long as they wish. This same sort of long-range outlook governs management decisions. While decisions in a non-family business often focus on short-term success, family business decisions may focus on achieving long-term results for children, grandchildren and beyond.

3. Employment practices

Employment practices are also likely to be informal, at least in smaller family businesses. The first criterion in hiring, firing, promotion, and compensation decisions will always be family membership. There normally will be a two-tier system with two sets of expectations: one set of expectations for family members and one set for other employees. There will be an implicit recognition that membership in the family entitles an individual to derive a good livelihood from the company. In many family businesses, family members almost have a guaranteed position in the firm. Advancement and compensation for family members may depend as much on the individual's needs as his or her abilities. Long-time non-family employees are often well-compensated and may even be given some stock ownership, but will never be given the same consideration as family members. **1.013**

Smaller family businesses may not have any formal job descriptions because everyone is expected to know what to do, and to do whatever needs to be done, regardless of the person's job title. This of course causes problems as family members age and younger individuals assume more of the burden of running the company. The lack of clear lines of authority and responsibility can create resentments and conflicts. **1.014**

B. RECOGNIZING OWNERS' GOALS

In advising a family business, it is important to identify the underlying goals of the owners. Although every business owner wants a strong bottom line and tax minimization, other goals may even be more important to many family business owners. Planning cannot be effective unless the adviser really understands what's most important to the business owner and what ultimate goals are to be achieved. Additionally, each client's expectations and goals will be a little different. A solution that worked for one family business may not work for another despite superficial similarities between the two businesses. **1.015**

1. Financial security for the family

A basic goal of many family business owners is family financial security. Most owners' immediate concern will be the financial security of his spouse after his death. When many family members derive their livelihoods from the family business, the owner will feel an immense responsibility in running the business in a manner that will assure their long-term financial security. Long-term security should not be confused with short-term success. **1.016**

2. Family business as a legacy

1.017 Many family business owners want to pass their businesses on to their families. Business owners hope that their family business will provide their children with both financial freedom and the ability to control their own financial futures. Business owners also believe that the family business will provide family members an opportunity for personal growth and creativity.

1.018 A significant number of business owners also believe that the family business provides a means to perpetuate the family's heritage and to build a common tradition for the family. Many family business owners view the family business as a way of promoting family harmony and keeping the family together. Without a family business, children might be forced to move away to follow career opportunities. These business owners feel that by having the family working together in the business, family bonds will be strengthened and family members will be able to spend more time together.

1.019 It is clear that family business owners are interested in a lot of non-financial issues, and the process of running the business may be almost as important as the financial rewards. In this context the business is a mere extension of the family unit. The family business is a family legacy that not only provides wealth for family members, but also perpetuates family beliefs and family values. Advisers always need to keep in mind that decisions in a family business can be driven more by family considerations than business considerations.

3. Family harmony

1.020 Another common goal is family harmony. Business owners hope to provide an environment that will promote family harmony. They see the family business as a means to provide financial security for the family and bind the family together. In fact, working together in a family business can have the opposite effect. Clashes over business problems sometimes destroy close family relationships. These problems can be minimized by carefully thinking through planning strategies.

1.021 Advisers may either ignore or shy away from helping to solve problems involving soft issues for a variety of reasons. Some advisers will not intervene in what they perceive to be "family" rather than "business" decisions. Many if not most advisers have no formal training in resolving such problems. Some advisers may assume that this area is the province of psychologists, not business advisers. Others may assume that personal family decisions must be left to the family or advice columnists to resolve. More seriously, advisers may assume that these problems really are not all that important, and will resolve themselves. In fact, none of these reasons – especially the last one – is a valid excuse for ignoring these problems. These soft issues can have a tremendous effect on a family business and evidence has clearly established that family problems – not competitive pressures – are the cause of family business failures.

Family business advisers simply must address the soft issues that arise in family businesses. Advisers need to recognize that these are in fact legitimate "business issues" that need to be addressed and resolved. Soft issues do not normally come up in publicly-traded corporations because stock ownership and control are not concentrated in one family. However, family personality clashes and squeezeouts can also adversely affect large publicly-traded corporations. Even these companies face problems when their management suite and boardroom resemble a soap opera. **1.022**

4. Perpetuation of the business

Although linked to the concern about the family's financial security, the perpetuation of the business is a separate and distinct goal of many business owners. Entrepreneurs work extremely hard and can be justifiably proud that they have built up a thriving business. Understandably, owners normally want their business to survive into the future – especially if the business bears the family name. However, in some cases, founders would prefer that their children not take over the business. Not surprisingly, owners of more successful businesses are far more enthusiastic about passing the business on to the next generation than selling it to an outsider. **1.023**

5. Planning complexity

Although most family businesses are relatively small, the complexity of the planning issues is unrelated to their size. Advising a family business is almost always complex because of the interplay of family and business issues. Business planning always has to be coordinated with the retirement and estate planning of the owners. What is good planning for the business may not be good planning for the owners. What is more, different family members typically have different needs and desires and even creative planning cannot always satisfy all these needs. **1.024**

C. IMPORTANCE OF "SOFT" ISSUES

1.025 Many advisers – especially accountants and attorneys – are uncomfortable advising business owners on what are sometimes referred to as "soft issues." "Hard issues" deal with money – providing financing and liquidity, or tax planning strategies. "Soft issues" involve family and personal problems that do not have quantifiable solutions and answers that cannot be expressed in simple terms. An example of a soft issue is sibling rivalry over who should lead the business. Although there may be sound business reasons for the father to select one child to lead the business, family considerations may argue against choosing one child over another.

D. FOUR PHASES IN RESOLVING PROBLEMS

1.026 There are four phases in resolving these problems. First, the family business adviser needs to appreciate that family problems quickly become business problems and can threaten the viability of the business itself. Second, the adviser needs to recognize warning signs and situations in which such problems can be expected to arise. Third, the adviser needs to take an active approach in forcing the family to address the problems. Finally, the adviser needs to help devise and propose solutions to help the family resolve their conflicts. This "partnering" between the family and the business adviser can be a rewarding experience for both sides. These issues will be discussed throughout this book.

E. RECURRING PLANNING ISSUES

1.027 Although each family business client is unique, there are certain issues that tend to be present in many if not most family businesses. If the issue is not currently a problem, the adviser should be alert for it in the future. Many of these issues will be discussed in later chapters of this book.

1. Addressing issues

1.028 The family business adviser needs to take an active and assertive role in recognizing, addressing, and solving these recurring problems. The failure rate for family businesses suggests that business owners need more involvement from their advisers. Advisers may be more sensitive than the owner to both the problem and possible solutions. In some cases the owner may be well aware of the problem but needs prodding to address the problem and then devise a solution to solve it.

2. Family conflicts

Although not all family businesses experience serious family conflicts, enough do to make this issue a serious problem. Family problems sometimes intrude into the workplace. Just as often, problems arise at work and then split apart the family. Conflicts typically arise because of varying expectations, values, needs, and wants. Family members who work in the business will have different expectations than family members who are merely stockholders. Conflicts can also arise between siblings, or can be intergenerational. Although each family conflict is unique, these conflicts seem to follow familiar patterns. Family conflicts are discussed in Chapter 2, Understanding Family Business. **1.029**

3. Power struggles, squeezeouts, and deadlocks

When family conflicts erupt they can create serious problems in the family business. The family may divide into various factions who may struggle for power and try to squeeze one another out of the family business. In some cases the board of directors and shareholders can deadlock, which can effectively immobilize the company. The adviser needs to anticipate these kinds of problems. These topics are discussed in Chapter 3, Family Issues in Family Business Operations. **1.030**

4. Protection of minority shareholders

Minority shareholders are frequently at risk when family conflicts escalate into power struggles and squeezeouts. Preventive planning can eliminate the possibility that minority shareholders will be unfairly treated. Family businesses typically use both stock and bylaw restrictions to protect minority shareholders. These techniques are discussed in detail in Chapter 4, Dealing with Power Struggles and Protecting Minority Shareholders. **1.031**

5. Compensation techniques

Compensating employees is always an important concern for family business owners. Because the family business provides both current and retirement income in many cases, the use of deferred compensation, stock options, and restricted property will need to be considered. The adviser will have to devise creative solutions with an eye to both income and transfer tax issues. These **1.032** issues are discussed in Chapter 5, Creative Compensation Techniques for Family Businesses.

6. Retirement planning

1.033 Retirement planning is especially important for family business owners since many of them will receive the bulk of the retirement income from corporate-owned retirement plans. Although these plans can provide a real tax advantaged opportunity, without careful planning they can also be a trap. Retirement planning is discussed in Chapter 6, Creative Retirement Planning for Family Business Owners and Their Families.

7. Succession issues

1.034 An inevitable issue in every family business is succession – who will succeed the current officers? This is the thorniest issue of all, and success or failure of succession planning will spell success or failure of the entire family business. Although the absence of a clear successor is a problem, the presence of two successors is a greater problem. The adviser needs to spend considerable time with the business owners to develop a succession plan that can help the family with the inevitable process of transferring control to the younger generation. Succession issues are discussed in detail in Chapter 7, Solving Problems in Succession Planning for Family Businesses.

8. Estate planning

1.035 Most business owners are aware of the importance of estate planning from both the family and tax standpoint. Despite this awareness only slightly less than half of surveyed business owners have gotten around to formalizing an estate plan.[2] Luckily there are several tax advantaged strategies that can help minimize transfer taxes for family business owners. Estate planning issues and estate tax are discussed in Chapter 8, Creative Estate Planning Techniques for Business Owners and Their Families.

9. Intra-family transfers

1.036 Although family businesses are sometimes sold to outsiders, intra-family transfers are equally common. The adviser will need to consider the pros and cons of outright gifts, installment sales, private annuities, self-canceling notes,

2 American Family Business Survey (2007) https://www.massmutual.com/mmfg/pdf/afbs.pdf.

grantor retained annuity trusts, and limited family partnerships. Other techniques include redemptions and corporate divisions to shift control. These transactions will need to be planned to minimize not only income tax but estate and gift taxes as well. These techniques are discussed in Chapter 9, Special Problems in Implementing Intra-Family Transfers.

10. Liquidity planning

Expansions, buy-outs, and death taxes require large amounts of cash. These **1.037**
large cash demands can leave the family cash-short. Even when there is cash in the business it may be hard to transfer money to compensate shareholders without triggering some tax. There are several tax advantaged strategies that can be used to provide liquidity for these real needs. Liquidity issues are detailed in Chapter 10, Creative Techniques to Provide Estate Liquidity.

11. Valuation

Valuation is important whenever an interest in a family business is to be sold. **1.038**
Additionally, because ownership of family businesses can also create a huge estate tax problem for business owners, valuation issues need attention in estate planning. Luckily, the tax code contains some favorable rules for family business owners. Discussion of valuation issues is found in Chapter 11, Valuation Techniques and Strategies to Minimize Taxes on Family Businesses.

12. Life insurance planning

Life insurance has a number of important uses in a family business. It can help **1.039**
fund a buy-out when one of the business owners dies, and it can also help pay death taxes. Insurance can be misunderstood and misused, so business owners need sound advice in this area. Life insurance issues are discussed in Chapter 12, Creative Life Insurance Planning for Family Businesses.

13. Financing

Family businesses often face challenging financing problems in operating the **1.040**
business on a day-to-day basis. They also face challenges related to succession and estate planning issues. The adviser can help meet these needs by suggesting creative financing strategies tailored to meet the specific financing needs of the business. Financing issues are detailed in Chapter 13, Financing Problems and Issues.

14. Income tax problems

1.041 Clients are always interested in minimizing income taxes. Avoiding double taxation and handling appreciated property both require careful planning. Luckily there are a number of strategies that can lower taxes for both the business and its owner. Income tax issues are discussed in Chapter 14, Income Tax Planning Opportunities for Family Businesses and Owners.

15. Related-party rules

1.042 The tax code contains many related-party rules, and these frequently come into play when advising a family business. The adviser needs to be familiar with the rules and must also be able to plan around them. The tax code's related party rules, including helpful examples, are detailed in Chapter 15, Negotiating the Tax Code's Related-Party Rules.

F. OVERCOMING THE CLIENT'S RELUCTANCE TO ENGAGE IN PLANNING

1.043 There are undoubtedly deep psychological reasons behind client procrastination in this area. Contemplating one's own death is not an uplifting topic and most clients would rather avoid the issue altogether. There are a number of more concrete obstacles that must be overcome. By engaging in succession, retirement and estate planning, the owner is setting the stage for these events. Some owners have difficulty in acknowledging that these events will come sooner than they would like.

1.044 The most obvious obstacle to planning is cost. Professionals charge for planning, and family business owners are naturally reluctant to pay for the planning. A way to overcome this obstacle is to illustrate the consequences of failing to plan. The tax costs of failing to adequately plan for succession can be enormous. A simple illustration of the toll of the estate tax on an unplanned estate or the tax-savings benefits of income-shifting within the family should convince most clients that these services are really cost-effective in the long run.

1.045 Succession planning and estate planning often require the client to make some unpleasant choices. Even if a client has decided to select one child over another to run the family business or to make a will that is sure to disappoint several people, it takes courage to carry out the decision and although a decision has been made the client may be reluctant to finalize the decision by putting it into a formal plan. The client may still be uncertain about the best course of action. Although some people make quick decisions, others wait until they feel they have sufficient information to be able to make a wise choice. Planning requires choices to be made for better or worse and can be uncomfortable when solutions are not clear-cut. When a solution is not obvious clients will want to avoid entering into an inflexible plan. For example, although one son may be the father's successor by default, the father may still harbor serious misgivings for one reason for another and may want to delay formalizing a succession plan as long as possible.

There can be other causes of resistance. Some business owners are secretive **1.046** and do not want to reveal their plans to either outsiders or family members. They may not want to share even basic financial information with their children – or even their spouse. These owners frequently exercise a high degree of control over not only their business but their families as well, and may be very resistant to any logical appeals about the merits of formal planning.

G. "WHO" IS THE CLIENT?

This is another seemingly simple question that may not have an obvious **1.047** answer. When a planner accepts an engagement with a family business the planning will necessarily involve the business and at least the majority owner. Planning for the business will have direct implications for those family members who work in the business, and for those who only own stock in the business. But it also has an indirect implication even on those who are merely potential heirs. The financial affairs of the business and the family can be inseparable.

Despite this, the adviser needs to focus on whether the business, the majority **1.048** owner, or the entire family is the client. The adviser owes a duty of loyalty and confidentiality to the client. If the client is the family, then these duties are owed to all. If the client is only the founder, then the adviser needs to keep this in mind. Further, the adviser needs to be alert for conflicts of interest and the need for confidentiality in dealing with personal information.

The adviser should use written agreements that address potential conflicts of **1.049** interest. After all potential conflicts are disclosed, all parties should consent in writing to the continued representation. For example, if an attorney is hired by the founder solely to represent her interests, the attorney should describe the nature and extent of the attorney-client relationship and the written retainer agreement and inform other concerned parties accordingly.