

A Holistic Approach to Family Business Succession Planning

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Abstract:

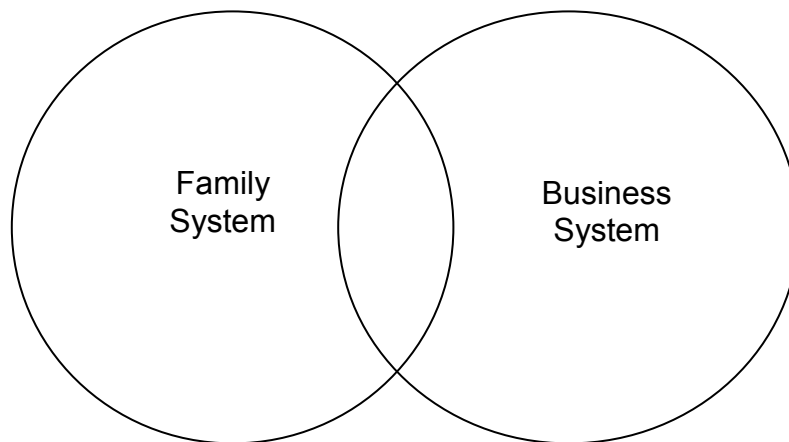
Typically, the family business advisor works closely with the business owner or owners to determine their wishes regarding the ultimate transfer of business leadership and distribution of other family wealth. Family dynamics often sabotage the best-laid plans. This article discusses a different approach: 1) treat the entire family as the client and determine each individual's needs before developing the new wealth transfer plan, 2) present the plan to the entire family in a retreat setting to assure everyone understands and supports the new plan. As compensation, the advisor charges a fee for the planning work. Advisors are required to change their focus from a transaction (sales of products or services) to a holistic planning process.

Article:

Much has been written about the challenges of working with family owned businesses. Most of these grow out of the interplay between the family members themselves and the relationship family members have with the business. The interplay of these factors is what makes working with family owned businesses so interesting and challenging. In their book, *Business Succession Planning and Beyond*, authors Dirk R. Dreux IV and Joe M. Goodman take a very useful approach to this subject.

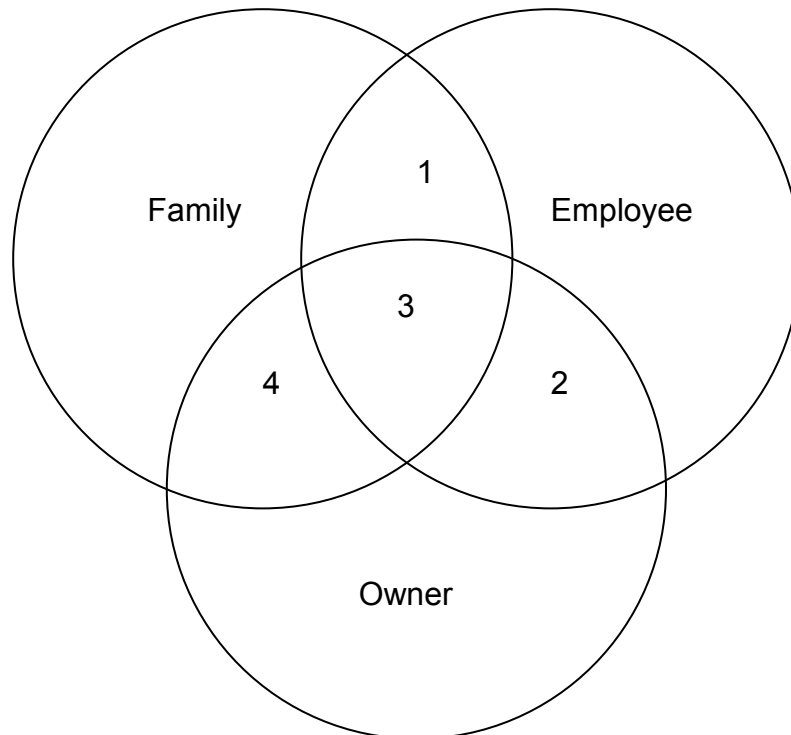
Family and Business Systems

According to Dreux and Goodman, the situation should be viewed as an interaction between two systems; the family system and the business system.¹ The family system is emotion-based with a membership that is accidental and for life. The business system, on the other hand, is more pragmatic and is based on the successful completion of the various tasks necessary to produce crops or widgets. The fact that both systems are made up of the same individuals means a certain amount of unavoidable overlap. The interaction between the two systems in a well-functioning family business can be illustrated thusly:



Unfortunately, in many cases the overlap is much larger than illustrated here. Extensive overlap of the family and business systems can be considered dysfunctional when it interferes with day-to-day operation of the business or with the long term planning for business succession.

The world of the family business is further complicated by the existence of the various roles played by individuals – in the family system and the business system. There are three primary roles: family member, business owner and employee. The overlap of these three roles complicates the business/family scenario considerably as illustrated below:²



The four areas where the three circles overlap represent 1) family members who are also employees, 2) employees who are owners but not family members, 3) family members who are employees and owners, and 4) family members who are owners, but not employees. Every family business doesn't necessarily have all these overlapping roles, but it's easy to see the complexity and potential for tension and misunderstanding when multiple roles do exist.

The overlap of roles impacts day-to-day operation of the business as many family dynamics, such as sibling rivalries and power struggles, play themselves out in business operations. In their book, Dreux and Goodman retell the amusing story of a family business situation originally told at a Family Firm Institute conference some years ago. Tom, the business owner's son, was dutifully working in the family business by "starting at the bottom." He couldn't help taking advantage of

his family position, however, when the opportunity to join some friends in a skiing venture presented itself. In spite of the fact that his supervisor refused his request for time off, Tom left to go skiing. When he returned from his vacation, he was instructed to meet with his father who was relaxing in the family hot tub. When he got there, he found his father in the hot tub wearing a double-billed duck hunting cap. The side of the cap facing Tom read "Boss." The father said, "I understand that, against your supervisor's orders, you left work for two weeks leaving everyone else to fill in for you. You're fired!" As Tom sat there stunned, his father turned the cap around. On the other side was the word "Father." The old man continued, "Gee, son, I understand you lost your job today. What can I do to help?"

It's a funny story, but it illustrates the balancing act family members – especially owners – must perform while balancing family and business needs. The balancing act becomes all the more serious when the subject turns to succession planning. The very future of the family enterprise may hang in the balance.

Meeting the Needs of the Business Owner

Most business advisors take the view that the business owner alone is their client. Their task is simple: find out what the owner wants and develop a business succession plan accordingly. Unfortunately, such an approach fails to take into account the family dynamics described above. While a plan could be developed that meets the needs of the owner, its ultimate success may depend on how well it meets the needs of other family members.

A real life case provides an example.

John and Martha owned a large and successful dairy operation that they operated with the help of their two sons-in-law. One son-in-law was in charge of the farming unit and the other was responsible for the dairy operation. Each man owned 20 percent of the business and John and Martha owned the remaining 60 percent. Unknown to John and Martha, both sons-in-law were unhappy in the business and secretly wanted out.

The two men did not get along and their relationship had been strained for most of the 15 years they worked together. During family celebrations the two men would sit on the same side of the table, but at opposite ends of the table – so they would not have to talk or even look at each other. John would spend much of his workday acting as go-between trying to keep the peace between his sons-in-law. Martha once confessed that she could tell how well things had gone during the day by how frequently John turned over in bed that night.

Separate in-depth interviews revealed that one of the families really wanted to move to another state and buy a smaller dairy. The other family wanted to stay in the area with John and Martha but operate their own, much smaller dairy.

Eventually, both couples did just that. Each family now owns and operates their own business and John and Martha have hired a non-family general manager to help them operate their dairy business.

This arrangement finally brought peace to the family. After adjusting to the initial disappointment, John and Martha became much more content. Under the new arrangement, all the stress caused by the family infighting was eliminated from their lives. Without the need to constantly referee family tensions, they finally had time to travel and enjoy themselves. John and Martha are satisfied with their new life and are considering plans to retire and sell the business to another dairy family.³

A typical business continuation plan, developed without full knowledge of all the facts, would probably have included a typical buy-sell arrangement between John and Martha and the sons-in-law to ensure the continuation of the business. That plan would probably have been doomed from the start given the animosity between the two future owners. A business advisor, taking the traditional approach of designing a plan to suit the current owners, could have developed a textbook perfect succession plan for the business, which in the end would prove unworkable.⁴

Proof that many business succession plans do not work is abundant. It has been estimated that only about 30 percent of family owned businesses survive into the second generation, 12 percent survive into the third generation and only three percent operate at the fourth generation level and beyond.⁵

In some cases, of course, the planning is simply never completed. That makes survival even less likely.⁶

The best strategy for developing a succession plan for the family business that has a high probability of working is twofold. First, the advisor should consider all the family's wealth as part of a single plan (think wealth transfer planning, not business succession planning) and second, the advisor should attempt to understand all the needs, hopes and expectations of all the family members and how they relate to the future of the business. In other words, the advisor should treat the entire family as the client. Adhering to these two principles can assure the family's wealth will be protected and the business preserved for the benefit of the family, employees and customers.

Advisor Orientation: Transaction to Process

Many family business advisors do not think of the business in terms of overlapping systems. Instead, the family business is perceived as a "market segment" with potential for sales. Depending upon the nature of the advisor's particular discipline, it might be the sale of a financial product, execution of a legal document or the accumulation of billable hours. In any case, the focus is

on some type of transaction. This is understandable because advisors are the product of their particular culture and are programmed to value themselves in terms of their sales “success.” In a transaction-oriented world, the advisor is paid only if and when a “sale” is made.

The key to incorporating the family/business system concept into the day-to-day work of advising family businesses is to change the focus. Instead of focusing on transactions – be they product sales or billable hours – the advisor needs to focus on the planning process. The process has a beginning, a middle and an end. It consists of logical, orderly steps. The goal of the advisor should be to successfully complete the process – which may or may not result in the sale of a product or service. Obviously, this has implications for earning a living. The income solution requires one to “think outside the box.” More about that later.

Understanding Family Needs

The process begins with understanding the needs of all the family members. If the goal is to understand the needs of the entire family, there is only one way to do it. The advisor must conduct in-depth interviews with each individual family member. Although this can be a time consuming process, it is vital if the family dynamics and other realities are to be considered in drafting the new wealth transfer plan. A critical component of the interviewing process is to guarantee confidentiality. Every individual in the family must feel totally free to express his or her true feelings about the transfer of the business and other family wealth. Anything less than total confidence in the process will affect the eventual success of the plan.

Since the goal of the interviewing process is to uncover feelings – sometimes negative and strongly felt – the advisor must remain impartial and open to all input. The role of the advisor at this point is not to guide the interview or steer the interviewee toward a desired outcome, but rather to gather information. In many cases, especially blended families, it might be best to interview husbands and wives separately. Again, the goal is good information. Honesty and openness are sometimes easier to achieve without the presence of a spouse who may have conflicting views on some topics.

Feelings about the business and one’s role in it cannot be obtained with closed-end questions. It is necessary to ask direct questions about feelings. For example:

“Can you describe for me your major concerns about the family business?”

“In what areas does your family communicate effectively? Poorly?”

“What issues cause communication to break down? Between which individuals?”

“Are you in favor of the business continuing in its present form?”

“What changes would you like to see?”

The answers to these and other probing questions about the individuals in the family and the family business and other wealth, will help the advisor understand how each family member perceives the future of the business and how they view their role in it. If a particular family member doesn't want any role in the future of the business, that is also critical information.

Once the individual family member interviews have been completed, the advisor should have a good understanding of the family's goals as they relate to the business, other family wealth and the individuals themselves. This forms the basis for the creation of a wealth transfer plan that satisfies all family members, not just the current owner or owners.

Developing the New Plan

This is generally the easy part for most professional business advisors. Devising a new wealth transfer plan calls for expertise in financial products, legal agreements and documents, and technical know-how. All of this is readily available. If the advisor does not possess a particular skill or expertise, he or she probably knows who to contact or where to go to find someone who does.

For purposes of this discussion, suffice to say that the practical knowledge and skill that comes into play designing the new plan, must be applied in a manner consistent with what was learned during the family interviews. Think of the technical skill as the back wheel of a bicycle, driving the vehicle forward. The people skill, in particular the family interviewing process, is the front wheel, guiding the process on its way. Strong technical expertise, without the proper guidance, can result in a transfer plan that could end up in the ditch at any moment..

Another important consideration when developing the new wealth transfer plan is the existence of an existing plan. If a plan is already in place, it's important to understand who developed it and why it was structured as it was. Other trusted family advisors who worked on the original plan may be able to provide insights into family dynamics that will be helpful in designing the new plan.

The most important thing to keep in mind while developing the new wealth transfer plan is that the technical solutions must support the *real* family goals as articulated during the individual family member interviews. Creating a new plan

that meets only the needs of the owner will almost certainly fail – regardless of its technical proficiency.⁷

Presenting the New Plan

The second most important aspect of creating a new wealth transfer plan, after determining the family's needs, is to present the plan in a manner that results in a consensus among family members that this is the right plan, worthy of their full support. The presentation should be directed toward this end result.

While the family member interviews should be conducted individually and in private, the new plan should be presented to the family as a group. A retreat setting, at a location removed from the family home and business, is ideal. The group setting is important because it offers the opportunity for all family members to react to the new plan and witness other family member's reactions. It's also an opportunity for the family members to share their feelings, hopes and even fears and apprehensions, regarding the future of the business and their role in it.

The advisor, acting as a facilitator, should conduct the retreat. It is important for the facilitator to create an open, safe environment for family members to express their views and opinions. This means accepting all input non-judgmentally and inviting full participation, regardless of potential impact. Obviously, there is potential for negative emotions, like hurt feelings and old rivalries, to surface. These seemingly disruptive developments must be allowed to play out so they can be dealt with in a constructive manner and finally resolved. If serious dysfunction exists, such as alcohol or other drug additions, a professional counselor may have to be included in the process. In any event, a full airing of the issues impacting the successful implementation of a new wealth transfer plan must take place. In the end, this is the only way the entire family can be assured that the new plan will succeed in meeting everyone's needs.

The advisor begins the retreat by asking each family member present to respond in turn to three questions:

“What are your expectations of this retreat?”

What do you admire most about your family and the family business?”

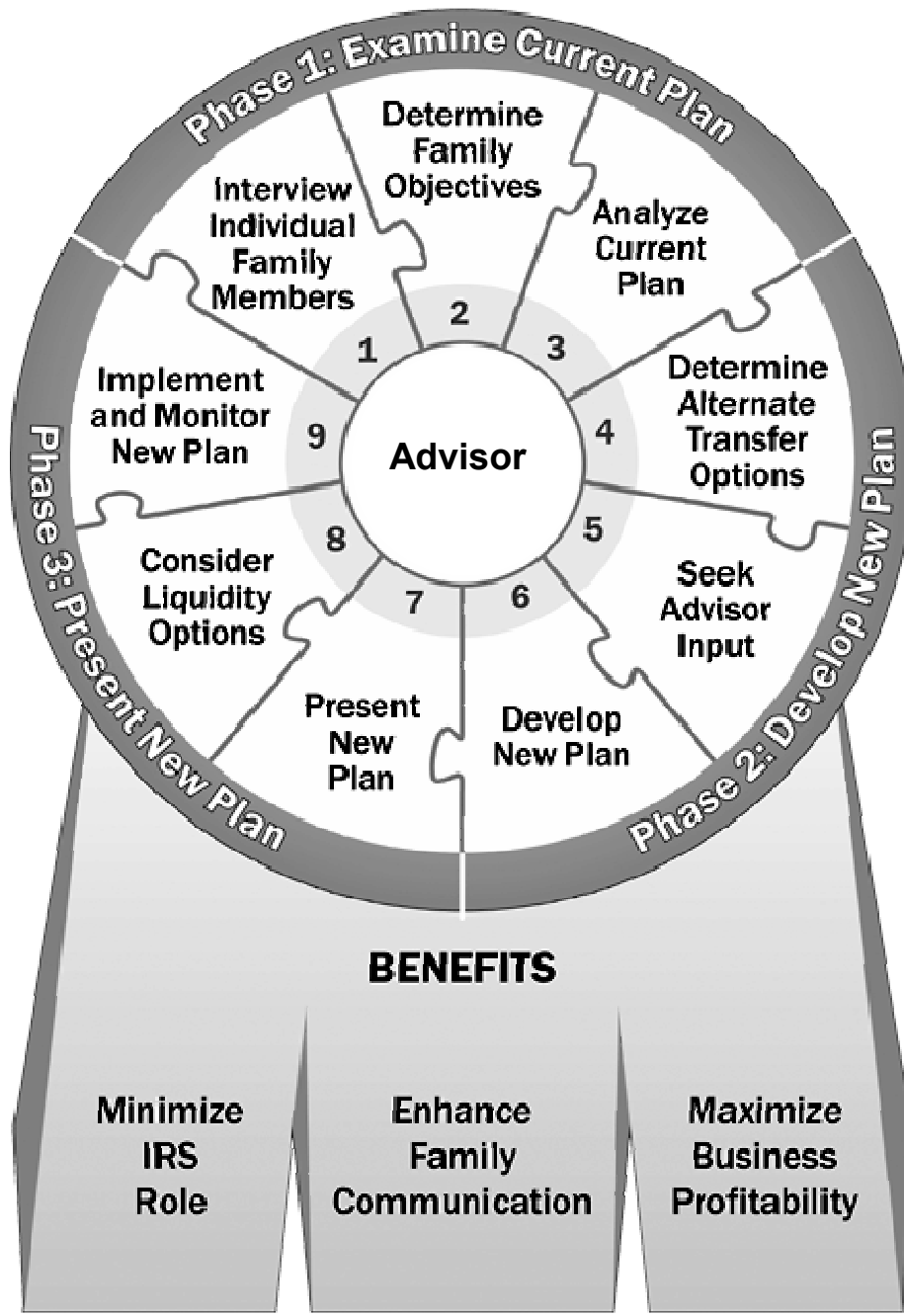
“What changes would you like to see?”

As each family member answers these questions, the full scope of feelings and expectations will surface. In many cases, this will be the first time the family has ever discussed these matters in detail. Parents will learn of feelings among their children that they have never dreamed existed. Children will develop an understanding of many of the issues their parents face, such as a deep desire to treat all the children in the family fairly. All of this will enlighten and inform the

deliberation process. The entire process, from interviews through acceptance of the new wealth transfer plan, will strengthen both the business and the family relationships. At the end of the family retreat, the family will not only have a better understanding of the operation of the business and its prospects for a more profitable future, but lines of communication will now be open – maybe for the first time. Future wealth transfer planning will be much easier to accomplish.⁸

The Planning Process

Although briefly summarized here, the entire planning process can be visualized as having nine steps and three distinct phases. The following diagram illustrates the process as a wheel supported by three pillars. The foundation pillars are the overall benefits of following the process. Minimizing the impact of taxation and maximizing business profits are expected outcomes of almost all business planning processes and should be the result in this case as well. Enhancing family communication, on the other hand, is a direct result of the commitment to treating the entire family as the client rather than working with the business owner alone.



Note that the advisor is the center of the process. The interviewing and facilitation skills of the advisor are paramount to the success of the process. The alternative is to accept the traditional owner-centered planning process and settle for the dismal odds against a successful long-term outcome.

Family owned businesses represent a fascinating field for the professional advisor. The fascination stems from the fact that virtually everyone involved wears two hats (or one hat with two visors) one representing family, the other the business. The key to successful planning revolves around addressing this dichotomy openly and honestly. The result is both a business and a family that is happier and healthier.

Compensating the Advisor

Obviously, interviewing every family member and spending a day or more with the family in a retreat requires an investment of the advisor's time. It's fair to ask how the advisor is to be compensated for this additional effort. The best answer is for the advisor to charge a fee, negotiated in advance. For convenience, the fee is broken into three segments. For example, one third of the fee is made payable at the end of the interviewing process, another third when the new plan has been developed and the final third, at plan implementation. It's important that the fee be clearly defined and its terms agreed upon prior to the work beginning.

One of the features of the fee should be a satisfaction guarantee. The guarantee protects the family business in the event the results of the process are not satisfactory. It also helps guide the advisor to legitimate prospects for this kind of work. If the family refuses to go along with the in-depth interviews, for example, the advisor should probably decline the case. Lack of cooperation signals a high probability of failure down the road. The satisfaction guarantee will give the advisor incentive to decline what is destined to be a poor prospect, because he or she will not want to spend time on the planning process only to be required to later refund the fees. In that respect, the fee structure, including the satisfaction refund, protects both the family business and the advisor.⁹

There are a number of benefits that flow to the advisor from using the process described here and charging a fee. First of all there is the personal satisfaction of knowing that the planning process is logical and will result in an effective wealth transfer plan that can be trusted to protect the business and other family wealth. Again, the strength is not in the technical solutions – any well thought-out planning process can develop sound solutions – rather, it's in the consideration given to the human side of the family and business. A second reward for the advisor is the satisfaction of knowing that family communication has been enhanced and that future planning will likely be improved as a result. Finally, charging a fee for this planning work represents a new source of income for the advisor. The fee approach eliminates the need for the advisor to sell a

product or service in order to receive compensation. The additional objectivity the fee brings to the process is also a plus. Owners are more likely to trust the advice of someone charging a fee than someone with incentive to sell products or services.

Changing one's practice from a focus on sales to charging fees is a big step. Many advisors will find this difficult because of past training and experience. Taking this step requires one to think in terms of completing a process rather than executing a transaction. Advisors trained to value themselves only in terms of whether or not they have made a product or service sale may find the prospects of such a change somewhat frightening. However, once that mindset is changed, the rewards – both in terms of financial rewards and personal satisfaction – are great.

- 1) (Dirk R. Dreux IV and Joe M. Goodman, *Business Succession Planning and Beyond*, The American Bar Association, 1997.)
- 2) "Bivalent Attributes of the Family Firm," by J. A. Davis and R. Tagiuri (1991), in C. E. Arnoff and J. L. Ward, *Family Business Sourcebook* (pp.62-73); Omnigraphics, Inc., Santa Barbara, CA
- 3) Karl Bareither, CLU, with Tom Reischl, CLU, ChFC, MSFS, *Becoming a Wealth Transfer Specialist*, CA: FBR Publishing, 2003
- 4) For a discussion of family and business relationships and the role of the advisor, see David Bork, Dennis T. Jaffe, Sam H. Lane, Leslie Dashew, Quentin G. Heisler, *Working with Family Businesses: A Guide for Professionals*, San Francisco: Jossey-Bass, Inc. 1996
- 5) Joseph Astrachan, PH. D., *Family Business Review*.
- 6) For a comparison of family-owned businesses that have planned for succession with those that have not, see Stephen M. Avila, PhD, CPCU, Ramon A. Avila, PhD, Douglas W. Naffziger, PhD, "A Comparison of Family-Owned Businesses: Succession Planners and Nonplanners," *Journal of Financial Services Professionals* 57 (May 2003)
- 7) For an excellent treatment of various techniques for transferring the family business, see William S. White, JD, CLU, CFP, Timothy D. Krinke, JD, CFP, David L. Geller, CLU, ChFC, CFP, "Family Business Succession Planning: Devising an Overall Strategy," *Journal of Financial Services Professionals* 58 (May 2004)
- 8) For a detailed discussion of the wealth transfer planning process, written for business owners, see Karl Bareither, CLU, with Tom Reischl, CLU, ChFC, MSFS, *Planning a Family and Business Legacy*, CA: FBR Publishing, 2003
- 9) Cultural factors sometimes figure into the principle of including the entire family in the planning process. Ethnic, religious or lifestyle prejudices sometimes make intra-family communication difficult. One of the challenges the advisor may face is the need to help a family overcome one or more of these barriers to effective planning. If the problem turns out to be insurmountable, the advisor should probably decline to work with the family. Accepting a case where one or more family members will be excluded from the process due to prejudice can potentially lead to an ineffective plan and refunding the planning fees. Excluding some members will make it unlikely that a plan can be developed that will be suitable to everyone. Under the terms of the satisfaction guarantee, the advisor would be bound to refund the fees in that case. Therefore, if this scenario exists, it would be better for the advisor to decline to accept the case.

Biographies

Karl R. Bareither, CLU is president and founder of FBR System, Inc. He is a fee-based wealth transfer specialist with 30 years experience in the family business market. Since 1995 he has been teaching other financial services professionals how to use a holistic, open process for wealth transfer planning. He is author of *Becoming a Wealth Transfer Specialist* and *Planning a Family and Business Legacy*. He is a life member of MDRT and the Top of the Table.

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