All in the Family

Blood and money can mix if members of family owned businesses put the ground rules in writing.

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By Benjamin Benson

Let’s consider “Bob Smith,” a successful drywall contractor whose adult sons, Adam and Zachary, work with him in the business. Bob loves both sons dearly, but knows full well that Adam is only using the family firm to avoid the real world, where he would have to compete on his own merits. Zachary, on the other hand, started out working in the warehouse during high school, has earned the respect of employees and customers, and is making a solid contribution to the business. Still, Bob is paying them equally and intends they will inherit equally, running the business to ether after he is gone. But the arrangement leaves him ambivalent.
More than 98 percent of the nation's 14 million businesses are privately owned, most by families. But making blood and money mix is seldom easy.

On one hand, he wants to treat his sons equally because he doesn't want a fight at home. On the other hand, he knows that—in the context of Smith Drywall Inc.—they just aren't equal. Adam doesn’t get much respect around the office and, if he wasn’t his son, Bob would probably fire him. Furthermore, Bob realizes keeping Adam aboard isn’t fair to the business, Zachary or, ultimately, to Adam.

Sound familiar? It should. More than 98 percent of the approximately 14 million businesses in the United States are privately owned, and the vast majority of these are owned by families. These firms produce a major portion of the gross national product, provide most of the country’s job growth, and directly influence the lives of most Americans.

Yet, the mortality rate of such businesses indicates building a lasting firm is no small chore. Fewer than five percent last long enough for a second generation to become involved, and a major reason is the conflicting needs of business and family.
Of course, some families achieve both business success and family harmony. Their firms provide them and successive generations with opportunities for work, financial security, and the satisfaction of sharing both sacrifices and benefits in a common endeavor. Successful families place an appropriate balance on the best interests of both the business and the family. They also tend to treat the business as a true family partnership, with members willing to make individual sacrifices for the benefit of both the family and the business.

The relationship between family and business may be defined in a written document stating the conditions under which family members could enter the business, be compensated and own stock. The specifics may vary widely, but written guidelines are appropriate for all family firms, since ambiguity leads to turmoil.

Unfortunately, most owners and managers are so immersed in day-to-day pressures they rarely take time to even talk about such issues, much less write a formal document. The subjects of sibling rivalry, compensation inequities and stock-ownership are avoided, perhaps on the theory they’ll go away. They won’t.

The best way to deal with such issues is a family meeting, preferably at a vacation-type location away from the office and the telephone. Participants should include all family members, whether active in the firm or not. Invite in-laws as well, so they can learn directly what is going on, rather than second-hand.

Some families bring in a moderator or “facilitator” who runs the meeting. This professional should be experienced in the issues of family-owned business, able to help identify issues, and keep the atmosphere non-confrontational. He or she doesn’t solve problems, but guides family members in doing so.

The right agenda is also important. Families are very different in their solutions to problems, but these issues or questions seem to be universal:

**Ultimate Objective.** Why does this business exist? Will it be kept in the family, sold, merged with a larger company or go public? Each requires a different strategy and places different demands on participants in the business.

**Succession.** Although no one lives forever, many company founders operate as if they’ll be the first exception. Successful transition to the next generation often depends on the ability of “Dad” to identify, train and apparently the most difficult part-install a successor while he is still alive.

**Estate Planning.** Distributing stock equally on the founder’s death may be “fair” to the heirs, but damaging to the long-term interests of the firm. When writing a will, the founder should take a realistic look at his children and, perhaps, at their children and spouses. Control should go to those who are active in the business. Placate the others with grandmother’s heirlooms.

**Family Creed.** A creed is a written document which helps avoid the managerial tendency to make exceptions to rules which are only “understood.”
“Schedule meetings away from the office once or twice a year to discuss progress of long-range business plans, strategy, and family relations?”

Among the issues frequently addressed in family creeds are the conditions under which family members will participate in the business, performance standards, compensation and the family’s philosophy about stock ownership.

Strategic Business Planning. Like most entrepreneurs, managers of family-owned businesses tend to favor a seat-of-the-pants operational style over a plan which sets goals and assigns responsibilities. In addition, most relatives want to avoid employer-employee roles. The result is an absence of both short- and long-term goals and strategies which makes many family-owned firms fall short of their business potential.

Reward System. When children are small, many parents measure slices of cake with a micrometer to avoid any appearance of favoritism. When these kids later join the business, their parents continue this safe practice, paying each identical salaries. Unfortunately, this does little to encourage high performance.

Performance Evaluation. Feuds sometimes erupt in family-owned firms over the charge that certain members aren’t doing their share. In reality, the problem may just be that jobs are poorly defined. Both performance and morale will benefit from a plan which defines everyone’s role and provides constructive feedback, not accusations.

Communication. Day-to-day business absorbs so much attention the family seldom has time to discuss how well its long-range business plans are working. Schedule such meetings once or twice a year to discuss both business strategy and how well the family creed (see #4) are working. To avoid distractions, choose a location away from the shop.

Who plays? Are all children free to join the business, or only those who have completed a specified course of education? Some family businesses require children to work a couple of years elsewhere before entering the firm.

Outside Opinions. Relatives are often too close to their business and each other to look at problems objectively. This is why many family businesses have created independent boards of directors. Composed of local business people, these boards advise managers on sales strategy, organizational structure and company direction. Overall, 10 to 20 percent of small businesses have such boards.

Editor’s Note: The author of this article, Benjamin Benson, is a partner in Laventhol & Horwath, a Philadelphia-based Certified Public Accountant firm, and a family business consultant. He is the author of the column, “A Family Creed,” in Inc. Magazine and has written for other publications on problems unique to family owned businesses.