



The Business Value Manager

*Advice
for business
owners,
investors and
service providers
on how to build
value and wealth
through
investment in
closely held
companies.*

Unique Challenges of a Multiple Generation Family Business

A hallmark of the U.S. economy throughout our country's history has been the family business. Founded or acquired by an entrepreneur, these enterprises, both large and small, often pass on to succeeding generations. Some have become very large and well-known with their ownership publicly-traded, such as the R.J. Wrigley Company. Others, such as M&M Mars, have remained privately-held by successive generations of the family.

Statistics on family businesses indicate how difficult "keeping it in the family" actually is. According to various sources, only 12% of family companies make it to the third generation with only 3% succeeding to the fourth. This edition of the Business Value Manager explores the unique strategic, financial and cultural challenges of ownership and management of a family business. The purpose of the article is not to provide a history, but rather, offer insights on how to make sound decisions about this unique investment.

YOUR FAMILY'S BUSINESS AND CULTURE

To begin an examination of your family business, start with an historical review and perspective. Ask the following questions:

- ✦ How and why did the business get started?

- ✦ Where is the company now from a strategic, financial and cultural viewpoint?
- ✦ Where will it most likely be from each of these viewpoints in the next five to ten years?
- ✦ What is the primary reason each family member owns the business?

FAMILY MINDSET

As you explore your family's business and culture, including why the business was started and why it is currently owned, a follow-up question clearly should emerge: Do we run it as a business or as a family? While some owners may wish to dismiss this question as too fundamental, it is critical that it be addressed.

If the company is run as a business, does it have a formal legal governance structure with clear lines of authority and a formal process for decisions? Does it have a formal reporting process

where both the company's performance and the performance of all executives are annually reviewed and evaluated? Are there jobs for all family members, or are qualifications, experience and performance measures employed in determining positions in the company, promotions and compensation?

Answers to these questions identify whether maintaining company legacy and family tradition is predominant,

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In your company, are there jobs for all family members, or are qualifications, experience and performance measures employed in determining positions in the company, promotions and compensation?

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versus having profits and family wealth serve as the priority. It has been our observation that the best run family businesses regularly address these issues and answer these questions. Business and family conditions change, so a clear understanding of these fundamental principles and processes provide guidance as these changes are encountered.

Wise business owners recognize that family members will view the company differently. Some views are more helpful to the business and its performance than others and some conflicting points of view may not be able to co-exist in the long-term. Different classes of stock, voting rights and other control mechanisms are available to manage these potential conflicts.

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ent goals and expectations. An individual's life circumstances, standard of living, level of wealth and desire for leisure change over time, particularly in later generations of a successful business. Non-family executives may become critical to the company's success, but they complicate management succession decisions.

It is critical for family members to recognize that issues surrounding management capabilities and commitment always exist. To be blind to them, or to ignore them, puts the company's future at risk. Addressing them on a regular basis not only increases the likelihood

of business stability and success, but family harmony as well.

A formal program for education, training and experience (frequently outside the family business) is essential. Carefully explore and test your children's commitment to the business and to the company's culture and values before you pass management authority to them. Install an appropriate system of *accountability* to accompany the transfer of *authority* to keep executives focused to achieve the company's goals.

Should you treat each child the same in terms of the role and authority you give them in the new company? Setting your child up to fail by giving him or her a job they do not want or cannot perform frequently results in family stress as well as business failure. Few family members possess the necessary talent and drive to become successful company leaders and parents frequently struggle to objectively evaluate a son or daughter.

SHAREHOLDER (INDIVIDUAL) PLANNING PROCESS

Most well-run companies – even smaller ones – engage in some form of annual planning to set the strategy and direction of the *company*. Our experience working with family businesses is that far fewer engage in annual planning at the *individual or shareholder* level. In a family business, this is particularly important because individuals own for both financial and non-financial reasons.

Planning at the shareholder level involves an annual examination by family members of why they own their portion of the business and what goals they want to achieve. This should apply to both those owners who work in the business and those who do not.

This examination should also address both the formal and informal governance structure that occurs at the shareholder level. For example, are decisions made by voting individual shares, by the vote of board members elected by shareholders, or by an informal decision by one or a few family members without a formal vote? Does the shareholder have any means to challenge or change this process? Are there formal plans in place for

Exhibit 1— Seven Very Different Perspectives on the Family Business

“I started this business from scratch and it must be carried on by my children.”

“I do not want this business to divide our family.”

“I'm the only competent and committed sibling and I have to deal with brothers and sisters who don't understand or care about the business.”

“I like owning a part of the family business, but my strategies and priorities are different than my dad's.”

“My professional career is outside of the family business, but it kills me seeing it run into the ground.”

“I like owning a piece of the family business because it gives my family the lifestyle and financial security we enjoy.”

“I like the fact that I own a piece of the family business. It gives me a job without bosses.”

FAMILY'S DILEMMA

Successful leadership of an enterprise requires education, training and experience, and successful managers possess ambition and commitment to business priorities.

In the family business, family members may have differ-

How Strong is Your Family Business?

YOUR CUSTOMERS

Past

- Who Were Your Customers and What Needs Did You Serve?

Current

- Who Are Your Customers and What Needs Do You Serve?

Future

- Who Will Be Your Customers and What Needs Will They Have?
- How is Your Ability to Meet Customer Needs Changing?
- How are Customer Relationships Changing and What Will Be Your Ability to Manage Them?

YOUR COMPETITION

Past

- Who Were Your Primary Competitors and Why?

Current

- Who Are Your Current Competitors and Why?

Future

- Who Will Be Your Future Competitors and Why?
- Is Your Company's Ability to Compete Against Them
 - * Improving?
 - * Declining?

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the transition of ownership and authority, and is this process and are these plans in writing and clearly understood? In our experience, we have observed that families who do not address these issues and cannot answer these questions frequently end up with disgruntled shareholders who lack a means to state their goals – financial or non-financial – or achieve their objectives for their ownership in the family business.

A far better alternative is an annual process where the company's financial performance, including its value and cash payments to shareholders, are disclosed and discussed. Shareholder roles in the company, non-financial goals and objectives and long-term transition plans and options are also presented, discussed and resolved.

CONCLUSION:

For the family enterprise to survive in the long term it must be run as a business, not like a family. This requires a formal governance process, including annual reporting and planning at the *shareholder* as well as at the *corporate* level. When properly implemented, this governance can yield business success, wealth creation and family harmony.

For an independent perspective and guidance on these challenges in your company, please give us a call. We counsel owners and executives on the steps necessary to make sound decisions to achieve your most important private company goals.



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The best selling book, *VALUATION FOR M&A: Building Value in Private Companies*, was co-authored by E&A principal, Frank C. Evans and David M. Bishop, and published by John C. Wiley & Sons, Inc. To order your copy, go to www.wiley.com/WileyCDA. For a preview, visit our website at www.evansandassociates.net, click the Publications link and Books.



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