NEWSLETTER

Aspen Family Business Group

The Aspen Family Business group: David Bork · Leslie Dashew · Dennis T. Jaffe, Ph.D. · Sam H. Lane, Ph.D. · Joe Paul · serves as a resource to help families create an environment in which members are open and willing to learn and grow. It is in such a setting that families are able to envision and achieve the positive possibilities of their business as well as maximize enjoyment of their family life. Our goal is for the family to develop harmonious, healthy, constructive interpersonal relationships and to maximize the success of their family-owned enterprise.

The Importance of Shareholder Education

Most people associate the idea of "succession" with the transfer of management authority and responsibility in the family business. Recently, however, there has been an increased emphasis on "ownership succession" as well. This shift has been in response to the substantial number of people who contemplate bequeathing ownership to family members who work in the business as well as some who don't. A second reason is the growing trend in family business governance to developing a "business partner team" in the next generation as the inheritors of ownership. A third reason is the recognition of the avoidable problems that can develop when the ownership side of the equation is neglected.

Terms like "stewardship" and "responsible ownership" are used to guide ownership succession, similar to the way "increasing shareholder value" may be used on the management side.

Successful ownership transition requires owners be knowledgeable about what they own and be able to use available tools to make values-driven, informed decisions. Achieving this goal requires a commitment, and resources.

This issue focuses on a number of different aspects of achieving knowledgeable ownership. Leslie Dashew talks about how to use a Family Council as a forum and vehicle for developing this knowledge and expertise. Dennis Jaffe addresses some of the dynamic issues involved when parents leave ownership to some who work in the business and some who do not. Sam Lane describes how family members need to be able to look at their ownership in the business as an investment. Joe Paul identifies factors that can be obstacles to smooth ownership succession when little preparation has occurred.

Ownership and management succession deserve equal attention and focus as the family prepares for the transition to the next generation. The overall success of the effort requires the integration and melding of both sides of the equation.

spring 2003

looking ahead

April 23, 2003
Next Generation Leadership in Wine Families
Santa Rose, CA · by Dennis Jaffe

♦

June 11, 2003
Creating Multi-Generational Governance
Structures for Family Wealth
IIR Family Office Forum, Chicago, IL
by Dennis Jaffe

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July 31–August 3, 2003
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A Seminar for Families in Business

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Ownership Education in the family council

by Leslie Dashew

The family business has a company plane...one nephew resented the fact that his cousin got to take trips on the plane while he couldn't.

While Dad was alive, she was sure the family business was run well. Now that her brother is running the business, she doesn't know if he's running the business well, or making the best decisions about the business she, too, owns.

The new president was not a member of the family. The offspring who inherited ownership of the business didn't know what information they should expect to receive from him...or what their rights are in giving him direction.

These are examples of issues faced by families who have become owners of a family business and who may not work in the family business. How do they become educated about the rights, responsibilities and roles of an owner? Many people learn about management or leadership in institutions of higher education or at seminars for managers, but where do family members learn about being owners? One such option is the family council.

As one family defined the mission, "The family council will provide a forum to further define our purpose, values and goals as a family, for continuous education as effective owners, to foster harmony and resolve issues, to provide direction to the board of directors about the expectations of the family owners and to establish policies on matters relating to the family and its assets."

The council can develop a curriculum to address the needs of family members to become educated owners from an early age. For one large family, we placed the ownership education outline (see sidebar on p.3) in a grid and assessed each member's level of competence in each area. Once we saw the areas of education needed by most

members, we addressed those areas at semi-annual family council meetings. For the rest, we developed individual educational plans so that each family member could pursue ownership education on his or her own. For instance, if many family members lacked the ability to understand the company's financial statements, the company financial executives came to a family council meeting to explain them to the larger group.

In another family, with primarily younger family members, we developed a financial literacy program along with activities to help the young people to understand the family history and values. What seemed like a game of "Scavenger Hunt" was really an exploration of the history of the family and its business. A Cousins' Club in one family was an investment club where the teens and young adults worked together to invest several thousand dollars in publicly traded stock and, through this, to learn about the fundamentals of business and how the cousins' different experience and knowledge could be pooled to make better decisions.

the cousins' different experience and knowledge could be pooled to make better decisions

The family council, as a safe haven for open dialog, also gives family members the opportunity to become educated by raising issues or concerns and gaining knowledge in response to that. For the cousin who was jealous of the family member's use of the plane, we explained IRS regulations on the use of company property and the policies that the company had developed to assure that the use of equipment complied with the law. This helped us illustrate the important boundary issues between ownership and management, and ground rules for good stewardship of family assets.

For sisters like the one who wondered how to evaluate her brother's effectiveness as a CEO, we offered information on appropriate expectations of CEOs, and guidelines about how to evaluate them. Further, we helped them to establish annual objectives for the CEO and instituted a 360° evaluation, so that key stakeholders would have objective information about the performance of the CEO and the company.

Where do family members learn about being owners?

In preparation for the succession of a new CEO who was not part of the family, the family council spent several years studying the role of the board of directors and the family council in governance. In the process of so doing, members of the family became prepared for the selection of a new CEO and were able to openly and knowledgeably develop an understanding of the key factors they should watch to determine the CEO's effectiveness and to request reporting which kept them abreast of his progress. They came to appreciate the difference between the operating responsibilities of the CEO, on the one hand, and the fiduciary responsibilities of the board to them, as owners, on the other. They also understood the principle of "Nose In, Fingers Out", so that they did not overstep their bounds as family members and owners.

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Family Ownership Education Outline

The following areas represent some beginning thinking about what conscientious owners should know in order to be good stewards of their assets, whether or not they are active in the management of the business:

Knowledge of our business as an investment

- Ability to evaluate in terms of return, financial strength
- Market value of stock
- Change in value of holdings each year
- Income/share
- Free cash flow
- Earning trends
- Debt/equity ratios, ROI, ROE, etc.
- Return as compared to other types of investments
- Diversity of the overall portfolio (emerging as well as mature businesses)

Knowledge of the business and industry(ies)

- Management effectiveness, trust in company leadership
- Strategic direction and position in industry(ies)
- Stability and strength of the company
- Awareness of the relevant industry trends, returns, challenges and opportunities

Personal Planning

- Personal strategic planning
- Financial planning (including estate planning)
- Capability of evaluating investment opportunities against own plans (amount of risk, exploring returns, etc.)

Role of Ownership

- Boundaries between ownership and management
- Role and operations of board of directors
- Evaluating management effectiveness
- Effective team participation and leadership
- Dealing with the psychological aspects of wealth e.g. embarrassment, shame, isolation, educating children, dealing with "predators" and identifying trusted advisors

The Gathering

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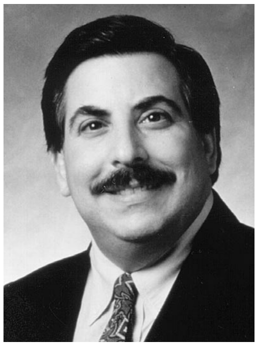
The Rights of Minority Family Owners: Creating a Family Marketplace

by Dennis T. Jaffe, Ph.D.



No source of misunderstanding can cause more havoc for a family than disputes between "insiders", family members who own shares and work in the business, and "outsiders", family members who have ownership but do not work there. These conflicts may have nothing to do with family dynamics, because similar conflicts erupt between shareholders and management of non-family businesses. But because family members are involved, of course, the emotional stakes are higher.

Here is a common scenario:

A family founder has established a thriving business and wants to pass it on to his children. One of his sons works there, and is slated to take over leadership in the coming years. Since this is a family asset, the parents have gifted equal 15% shares of the business to each of their three sons and their daughter. They are leaning toward offering most of the remaining 40% ownership to their son in the business, with cash and real estate to the others.

Sounds familiar, and depressingly normal and reasonable, but issues arise between the siblings about this arrangement. First of all, the brother wants all of his parents' shares to be given to him, allowing him the majority control of the business. His brothers and sister are upset, because they feel that it should be passed along equally; they are also upset at what they feel is his much too large salary.

The diverging interests between ownership and management in a family business are clear. The non-managing siblings want their asset to be "worth" something. They want a regular return on what may be their major investment. The son in the business wants to reinvest profits in growth and development, for the future of the business. And, of course, he feels he more than earns his salary!

This tension exists in all companies. Witness the controversies about executive pay, and about dividends vs. reinvestment in public companies. Investors often feel short-changed by management, but in a public company investors can vote by exiting from the investment, and there is a public market for shares. In a closely-held family business, the lack of a market leads the minority family owners to feel precious little influence or leverage for their interests.

The resolution of these issues is to create a family marketplace for the business. A family asset is not an asset to a minority family owner, if they cannot enjoy it.

The traditional family business had a paternalistic family leader, who decided how much to distribute to family shareholders. He/she (usually) would say that he was looking after both the needs of the family members and sustaining the business. In practice, while this may have been the intention, family members can resent and disagree with the paternalism of their sibling, and even feel there is a degree of self-dealing in salary and benefits.

The family has to sort business from family issues. While the son has contributed to the growth of the business over the years, like any key employee, he has ben well compensated by the owners. He really has no "right" to be given all or most of the business for his service. His brothers and sister have their own "right" to inherit the business as family members.

The resolution of these issues is to create a family marketplace for the business. A family asset is not an asset to a minority family owner, if they cannot enjoy it. Many family heirs feel frustrated because they own shares in huge and valuable businesses, but they cannot afford to buy a home or set themselves up in their own businesses.

The family market is premised on the principle that family members who inherit shares of a business must maintain their ownership voluntarily. If they are captives of the business, or do not feel that their interests are represented, their frustration will build into anger. If a family member inherits ownership, the family should find a way to offer to buy the shares of family members who do not want them. A family exit strategy will allow a family heir to decide to invest in some other direction, possibly sacrificing the shared family enterprise for personal financial autonomy.

The son who moves into leadership in the business experiences more freedom, because family members who are not satisfied with the rate of return for their investment can leave. The family business leader may have to arrange to purchase more ownership from other family members by recapitalizing the company. Firms like DeVissher and Company in Greenwich, Connecticut, specialize in helping family members recapitalize their businesses without sacrificing family control.

So, a brewing conflict in the family may be averted by allowing the managing son to purchase his extra shares from the parents, offering them cash that they can pass on equally to their heirs.

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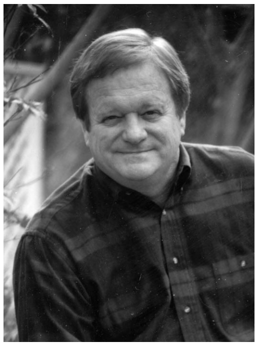
Ownership Seen as an Investment

by Sam H. Lane, Ph.D.



One important component of being a knowledgeable shareholder and a responsible owner is being able to assess and discuss how the business is doing from an "investment" standpoint. Many family businesses don't ask this question until a problem develops and somebody gets upset. In addition to forestalling avoidable problems, it is just "good business" to evaluate how one's investment in the company is doing, compared to other alternatives.

Part of this question comes down to determining how investment in the company compares with other alternatives for placing capital using various criteria such as risk, return, liquidity, volatility, etc. Sometimes even posing these questions raises anxiety because it suggests someone is interested in either selling the company or divesting of their ownership. This can be another reason the topic doesn't come up much.

What is the business worth?

However, the family needs to be able to discuss this topic openly so all are informed. It shouldn't seem like something is being hidden or can't be discussed. It may not be easy for shareholders to be informed on the many complexities regarding the value of their ownership. A number of factors come into play that might be unfamiliar to someone not well-versed in finance.

Sometimes the value of the investment goes beyond a dollars and cents question and touches on "The Family Factor". This means the subjective, intangible or emotional value of the business to family members. The Family Factor may play a strong role in conversations about the worth of the business as an investment. It still should not crowd out an objective assessment as well.

It is common in the world of personal finance to compare an investment with a series of alternative benchmark investments and look at the profile of one against the others. This profile is made up of the criteria factors mentioned earlier. The choice should be guided by the investment goals of the investor. Most people are familiar with the concept of a CD. It gives a specified rate of return, is guaranteed and is set for a period of time when it becomes liquid. The CD is one benchmark alternative that could be used, among others, to assess one's ownership position. Most alternatives range from lower risk and lower returns to higher risk and higher returns. Again, it becomes a comparative evaluation: "How does my investment in the family business compare with other alternatives?"

"How does my investment in the family business compare with other alternatives?"

Notice this discussion only focuses on the need to assess this information, it does not address what one should do with the results. Lower than desired results can be used as a motivator to increase the performance of the business. Good results may have a settling effect on shareholders who question the performance of their investment.

This question also comes up when someone asks: "What is the business worth?" In this case, the "value" of the business is probably best determined by using formulas consistent with the particular industry. However, many times a business appraiser will discount the value of minority ownership for lack of marketability, lack of control or other factors. This may create dismay for an owner because he or she may feel a share is really worth X when the appraisal comes back X discounted by 40%. An equally complexifying corollary is that in the discount scenario, in order for the minority shareholder to receive full value for the business, the entire business must be sold. These are issues that families must face when they address questions of partial or whole redemptions and buy-sell agreements.

One straightforward metric for assessing a company's performance is the Return on Equity or Return on Investment. The Return on Equity calculation lends itself easily to comparisons with other investments. Evaluating the acceptability of a return should be based upon comparative risk/award considerations. Some people tend to confuse dividends with returns but they are unrelated. Other business health indicators of the company should be considered as well, such as balance sheet ratios, free cash flow, revenue, margins and earnings trends and capital requirements, etc.

"What is the 'total return' of the portfolio?"

A second case occurs when the family has a portfolio of assets. In this case, one important question is: "What is the 'total return' of the portfolio?" How does this total return compare to a similar investment in a variety of different asset classes? In this case, "risk" is typically addressed through asset allocation. It is important to educate shareholders and give them the tools they need to evaluate the value and performance of their ownership and to make informed decisions.

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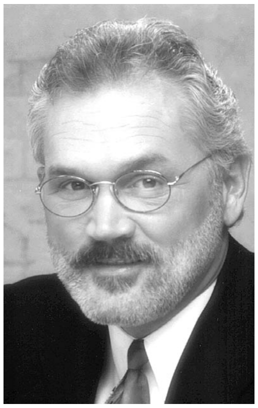
The Voice of an Owner

by Joe Paul



I once had a first meeting with four siblings a week after their father's unexpected death made them equal owners of his company. Two of them had worked in the company for twenty years. The other brother and sister had never worked in the company at all.

Without warning, because of their father's estate plan, each of them became an owner of a demanding business with three other partners. Their three new business partners were people whom they loved, but under normal circumstances the group of four never would have chosen to become partners in a business.

The death of their father had suddenly forced them into roles and responsibilities that they had never had together. They knew how to be brothers and sisters and could very comfortably talk to

The death of their father had suddenly forced them into roles and responsibilities they had never had together.

one another in those roles. The two who worked in the company had performed well together for years as managers and their conversations about day-to-day business operations were very familiar to them. But the four of them had never in all of their lives had a conversation with one another as owners in a business partnership. There was a lot of experience working ***in*** the business as managers, but not much in working ***on*** the business as owners.

As our initial meeting unfolded, the brother who had never worked in the company sat up straight in his chair, turned to his sister (now the company president) and said, "Beth, from now on whenever you spend more that $100,000 on anything, I want you to consult with the rest of us first." His sister was quiet for a moment. Finally, she turned to her brother and said, "Doug, I might need to do that four times a week. I don't have the time to

He was just trying to act the way he thought an owner should be acting.

track you all down and talk to you every time I spend that kind of money."

Doug blushed. Neither he nor his siblings knew what to say next. Doug hadn't intended to insult his sister. Neither had he meant to show how naïve he really was about the family's business. He was just trying to act the way he thought an owner should be acting. Instead, he had made himself feel very foolish and his siblings very awkward.

I realized I was watching a man trying to *find his voice* in a role and a set of relationships that was totally unfamiliar to him. I realized that this issue of "finding one's voice" in the role of an owner was often a factor in the succession process for family businesses. I also realized that there are both individual factors and characteristics of the group that create and perpetuate this lack of a legitimate voice.

Individual Factors

- Dominance of one strong personality
- Passiveness of an individual due to their role in the family (e.g. "The Baby Sister")
- Inhibition due to ignorance about technical issues
- Fear of creating conflict
- The elders fear of letting go of control
- The elders fear that their children are not competent

Group Factors

- The deference that children typically show to their parents or other family members
- The lack of a context for discussion (no formal Board or shareholder meetings)
- A history of meetings where one leader just tells others what has happened lately and what will be happening in the future
- The absence of or disregard for any kind of parliamentary procedures
- Lack of trust among family members
- Destructive competition among family members

Effective partners in business need to be able to think well about complicated issues together. To do this, they need to communicate skillfully. Any of the issues listed above can suppress the ideas of the group and it is a liability

Effective partners in business need to be able to think well about complicated issues together.

for the company for one or more of the owners to have no voice. If any of these are factors present among the owners or future owners of your company, they need to be dealt with. To avoid them for the sake of "keeping the peace" will actually lead to conflict that you are trying to prevent.

In the article in this newsletter by Leslie Dashew, you will find useful ideas to counteract the burden of having no voice, but one fact is important to remember. Others cannot give you a legitimate voice in any aspect of life. You must earn it and develop it yourself. Others can only give you the space to do that.

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2. **Let’s Celebrate the Good News for Family Business**
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