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# Family and Business Succession Planning

*Leading Lawyers on Evaluating Recent Trends,  
Navigating Uncertain Tax Laws, and Developing  
Creative Strategies for Families and Businesses*

2010 EDITION



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Successful Family Business  
Transitions Depend on Three  
Things: Process, Process,  
and Process

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## **Introduction**

For too long, attorneys, accountants, and other advisers to family businesses have tried to apply general business succession rules to family businesses. Today, advisers to family businesses need to recognize that family businesses are inherently different from their non-family counterparts. The family dynamic brings new opportunities and new challenges to helping a business succeed, and to ultimately transition ownership from one generation to the next. A multi-disciplinary approach is critical for family businesses and the families that own and surround them—and key to success is using those disciplines to help drive an ongoing process within the business AND the family.

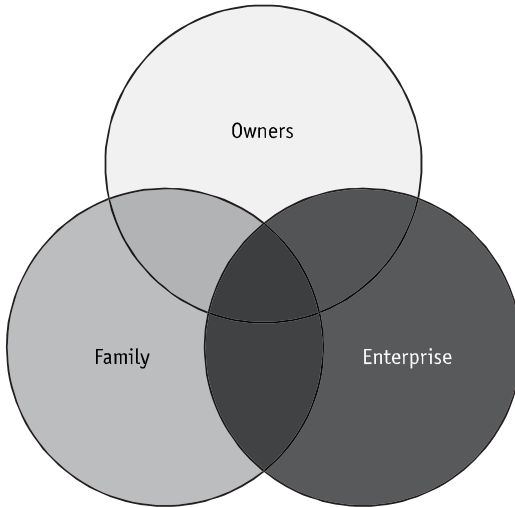
In this chapter, we will see that we need to carefully examine at the family business and the systems that drive the business, the owners, and the family itself. We will also consider the effective use of advisers to best implement a long-term operating and transition plan for the business. You will see that process becomes critical to success—not a formulaic, static process, but a dynamic, fluid process that shifts over time to fit the needs of the family and the family enterprise. In all, this chapter will provide an overview of the concepts and some common elements of the process in this rapidly growing field of expertise, and will offer some best practices for families and their advisers.

## **Family Business Background**

Family businesses play a huge role in our business culture. Depending on the source, it is estimated that 80 to 90 percent of our country's businesses are family businesses, and approximately one-third of the Fortune 500 companies are family-owned. More than 60 percent of our country's gross domestic product comes from family businesses, and they employ over 60 percent of our workforce. Globally, family businesses generate 70 to 90 percent of global GDP (see the Family Firm Institute Inc., Global Data Points, [www.ffi.org/default.asp?id=398](http://www.ffi.org/default.asp?id=398)). However you slice the data, family businesses are crucial to the economic success of the United States and the entire globe, as well as to society at large.

## Systems Theory and Advisers to the Systems

Classical systems theory has helped us understand how these family business systems work. In systems theory, the process of inputs, a systematic system of dealing with those inputs, the generated outputs, and a feedback loop that further influences the inputs is examined to gain a better understanding of how the system operates. As system theory relates to family businesses, the following three-circle model has become ubiquitous:



See R. Tagiuri and J.A. Davis, Bivalent Attributes of the Family Firm, *Family Business Review* 199-208 (Vol. IX, No. 2, 1982).

While one may argue whether this model covers every system involved within a family enterprise, all of these systems are present in every family business. It may be obvious, but it is helpful to define what individuals are in each circle.

Family:

The family group consists of individuals who are part of the family, but who may or may not be part of the management or ownership of the business. It is important to recognize that each individual (as well as groups of individuals) has his or her own internal system and set of values, needs, and goals.

**Ownership:** This is probably the most obvious, but these individuals actually own the business. They often are concerned with liquidity from the operating business, and they need not all be family members.

**Enterprise:** The individuals in the enterprise include the management personnel, board members (perhaps—they often straddle systems and play a distinct and separate role), and anyone who works in the business. Again, they may also be owners and/or family members.

It is not always easy for the individuals themselves to clearly identify what system they are in (note that they may move among the systems and intersections). For example, some family members, even though they are not owners, might act much more like an owner than other family members who are owners, but do not act the part. Quality advisers can help each individual understand the different systems and develop behavioral guidelines for the individuals in each system.

As you may have guessed, the intersections of these three systems hold the keys to how well they work together. Note that any given individual may be in one, two, or all three systems, resulting in seven different subgroups. The key is finding the right balance between independence and interdependence between each system. Generally, every family business has a balance point that helps maintain that balance between the family and the owners and between the owners and the enterprise. (Cary J. Tutelman, Ph.D, and Larry D. Hause, J.D., *The Balance Point: New Ways Business Owners Can Use Boards* (Famille Press, 2008)). As the business grows and the family is considering transitioning ownership, how these systems will stay in balance plays a key role. In other words, these balance points need to be recalibrated during transitions.

For example, if the matriarch of the family helped balance the family and the owners, families often consider establishing a family council to replicate the balancing role she played in the past. Or, if the patriarch kept peace between the owners and the enterprise (where he is often the only player on

both sides), he might establish a board of directors to balance those systems after he steps down from day-to-day control of the business. Working through these issues has value—having properly aligned ownership and control of the business has historically led to better results for family businesses. (See Catherine M. Daily & Marc J. Dollinger, “An Empirical Examination of Ownership Structure in Family and Professionally Managed Firms,” 5:2 *Family Business Review* 117 (1992)).

Care must also be taken by non-family members who are involved in the management of the business. Many family businesses now have management personnel from outside the family, up to and including the chief executive officer. As you might imagine, these non-family members of management must understand and work within these three circles of the family enterprise system. At the same time, the family must help the non-family management with this process. These are delicate issues, and key characteristics of successful CEOs of family businesses have emerged, along with key strategies and tactics that both the non-family CEO and the family owners of the business employ to be successful. (See JoAnne Norton, “Beating the Odds: How to Improve the Probability of Success of Non-family Chief Executive Officers of Family Firms,” *FFI Practitioner*, Volume 3, February 2007.)

Outside and surrounding these three circles, advisers (attorneys, accountants, psychologists, executive coaches, etc.) play a critical role. The enterprise as a whole, as well as each circle and each individual group within each circle, should be clear about which group or individual(s) the adviser is serving. It is also important to recognize the differences among the types of advisers. Generally, advisers tend to play a technical role, advising one or more of the groups how to best achieve a goal. This person can be referred to as a *personne de affaires*, generally someone who is an important adviser who imparts knowledge, but does not rise to the next level. The advisor rises to the next level when he becomes a *personne de confiance*, or one who imparts not only knowledge, but also courage. (James E. Hughes, Jr., *Family: The Compact Among Generations* 233-63 (Bloomberg Press, 2007)). Others refer to this person as the “trusted adviser.” Whatever label one puts on this person, she or he plays a key role for the family—so knowledgeable and trusted within the enterprise that she or he can have a great effect on the direction of the family and the business. This person can be anyone from a longtime

friend, to an accountant, lawyer, or other adviser, to a spouse. An enterprise can have different trusted advisers for different purposes, and the trusted adviser can change over time. Every family enterprise should have at least one *personne de confiance*, and every adviser should know who that is. If a family is looking for such a person to guide their family and their entire enterprise, they should seek out people who “describe themselves as ‘called’ to this work.” (James E. Hughes, Jr., *Family Wealth: Keeping It in the Family* 94 (Bloomberg Press, 2004)). The family must find people who are driven to never do harm and who are willing and able to take a very long view (twenty-five, fifty, seventy-five years) of the family’s success. *Id.* In sum, identifying the roles each adviser is playing will help the family and the advisers alike.

Working alongside the advisers and trusted advisers are family business consultants. These consultants by no means replace the crucial roles played by advisers—they play a role that is separate and distinct. We will discuss the role the consultant plays in the transition planning in more detail below.

In all, the three-circle model can help guide families, the family business, the owners, and their advisers in the best places to focus their efforts.

### **Three Kinds of Capital**

Although not directly related to systems theory, the family also needs to remain mindful that it is responsible for much more than just the financial success of the family and the business. In any family, there are three different types of capital, each of which must be measured and grown for the family to achieve true, lasting wealth: financial capital, human capital, and intellectual capital. (Hughes, *Family Wealth* at 17-19.) Even with regard to financial capital, family businesses are inherently different. During the founder years (also known as the “controlling owner stage” or the “owner-manager stage”), the capital is very “patient”—the owner is willing to leave most of the capital in the business to grow over time. However, as a transition to a new generation approaches, tension can arise because later generations have different liquidity needs and are less likely to settle for that type of patient capital. To effectively control these transitions, the family must implement some control and governance structure to help find the right balance. See Francois de Visscher,

*Balancing Capital, Liquidity and Control, Family Firm Finance*, October 2004  
(available at [www.devisscher.com/publications.html](http://www.devisscher.com/publications.html)).

In many families, financial capital gets all of the energy and attention—hopefully the family is working to establish and maintain the balance of the competition over capital. Surely that is enough to preserve the family wealth, right? Not entirely. Families must also be responsible for their human capital—rearing their children and keeping them healthy is critical to the family’s overall wealth. Beyond just the health of the family members, they must also advance the intellectual capital of the entire family. Successful families create a wide range of policies to proactively address areas of possible contention and ambiguity. For most families, education becomes paramount, as does the sharing of knowledge gained among all members of the family. (See Huges, *Family Wealth* at 17-19.) For example, some families insist that their children work for a number of years outside of the family business and reach a certain level of success, bringing the gained social knowledge back for the benefit of the family business and the entire family itself. Then, when they return, a job is not created for them—they participate on a fair basis within the firm.

As the family works through identifying, measuring, and growing its various forms of capital, it will be guided by its shared values. These values range from educational and charitable beliefs to long-term growth and dividend plans for the company. The family must identify these shared values and form a social compact to ensure that the values are not lost through the generations. (See Huges, *Family Wealth* at 19-21 and, generally, Huges, *Compact*.)

Only when the family advances all types of family capital and forms a social compact based on its shared values will long-term family wealth and true business success become attainable.

### **Finding the Path through These Systems Requires a Dynamic Process**

How to work through the interplay of the interlocking systems and types of capital is the crux to making family transitions work. This is where the final outside player plays a key role. A family business consultant can work in and among the various systems, together with the advisers and the trusted

advisers, to ensure that all pieces are working as smoothly as possible. (See Jane Hilburt-Davis and W. Gibb Dyer, Jr., *Consulting to Family Businesses: A Practical Guide to Contracting, Assessment, and Implementation* 10-17 (Pfeiffer, 2003)). In other words, the true role of the consultant is to make sure everyone is playing their appropriate role and facilitating the development and implementation of processes within the family system. In the three-circle model, consultants can operate within the center intersection among all three groups, ensuring that the interests stay aligned and balanced over time. They can also be key facilitators to help each group within the system define and hone their values, needs, and goals.

Finding those so-called values, needs, and goals is an entire process in itself. A family must look beyond the here and now and consider both where it came from (its ancestors—three generations back) and where it would like to go (its descendants—three generations forward). Finding the values that stretch that span or should span that amount of time will give the family true direction.

How does a family embark on this dynamic process? James Hughes offers one set of suggestions and considerations in his 2007 book, *Family: The Compact Among Generations*, in which he provides more detail as to how a family can adequately develop a governance system and utilize advisers for a family's long-term success. (James E. Hughes, Jr., *Family: The Compact Among Generations* (Bloomberg Press, 2007).) Other commentators suggest similar approaches. For example, in their 2001 book, *Strategic Planning for the Family Business*, Carlock and Ward propose a systematic process they call the "Parallel Planning Process," which can be an excellent way to integrate the determination of the family's vision and values into and parallel with the business plan itself. (Randel S. Carlock and John L. Ward, *Strategic Planning for the Family Business: Parallel Planning to Unify the Family and the Business* 24-50 (Palgrave Macmillan, 2001).) Whichever path resonates for a particular family, the process pays off. Research has consistently shown that following this type of process and looking at family systems together with business systems create better results within the family at large. (See Rodrigo Basco and Maria José Pérez Rodríguez, *Studying the Family Enterprise Holistically: Evidence for integrated Family and Business Systems*, 22:1 *Family Business Review* 82-95 (2009).)

The process of identifying and articulating shared values is long and hard, and families need to recognize that while they need to make decisions and not wallow, they must do so deliberately and slowly. This process takes considerable time, but the reward is great. The process is critical to the success of a long-term transition of wealth in the family, as well as ownership of the family business. In practice, it takes at least three to five years to develop a comprehensive and honest transition plan, one that honors the integrity of the family. Throughout that time, communication about values, needs, and goals and the process itself is critical. After that time, the process continues again.

Finally, the transition process must also consider, develop, and help to mentor the individuals in the next generations. (See, e.g., Katherine Grady, *Mentoring the Next Generation*, Families in Business (June 2002).) This is a difficult process, and often very difficult for the entrepreneur in the first generation to accept. Why? Because this involves going beyond “hard” business decisions and venturing into the “soft” issues of personal development (see, for example, Greg McCann, *What They See Is What You Get*, Generation Magazine, available at [www.familybusinesshelp.com/articles.php](http://www.familybusinesshelp.com/articles.php)). Nevertheless, families in general, and the senior generation in particular, can tend to ignore the values, needs, and goals of the next generation (and the mentoring needed to discover them) at their own peril.

## **Best Practices**

The path that each family takes is necessarily different. Each family must do its own work to find the best way forward. Nevertheless, there are certain best practices that have emerged that most families should consider.

### *The Path Itself*

First and foremost, recognize that the process has value in and of itself. It is tempting to seek a particular goal or outcome, but let the process unfold and find the true shared values of the family and the business and build on those.

### *Use of Advisers*

Along that path, find advisers committed to family-business success and with proven record of their understanding of family business issues, and recognize the different roles they can play. They should be divided into consultants, advisers, and trusted advisers (or *personnes de confiance*). Each has an important role to play, but they need to work as a team and recognize the role they are playing. Families who can get these teams working together effectively find success.

### *Family Values*

Successful families have good, honest discussions about their shared values, and they form a social compact to stay true to those values. They recognize that their individual family members are their assets and much of the system is driven by human behavior and perception. A well-considered and clearly articulated set of values recognizes this fact, deals with it honestly, and effectively trains and educates their individuals. These values underscore the family's policies and how it plans to preserve and grow its family capital.

### *Governance*

Effective families have effective governance. Generally, as the family business transitions to a new generation of ownership, the need for a board of directors focused on the needs of the business becomes more important. Also, to further the family's social compact, family councils can be incredibly effective. Finally, consider an owner council to deal with issues particular to the owners (who, remember, may or may not be the same as the family members).

### *Policies*

Finally, if possible, establish important policies before they are needed. For example, will the family require family members to work outside the business for three to five years before they can get a job in the family business? What will guide the decision of when and whether to declare dividends from the business? Under what circumstances will a family

member be able to cash out and sell her shares to the company? In general, successful families consider what policies are most important to them and work through them before they are critical. When this happens, families with established advisers, articulated values, and solid governance (see above) can more readily adapt and implement policies as they are needed, without causing great disruption to the family or the business.

### *Why Don't All Families Follow this Path?*

In my experience, the leading reason that families do not follow these best practices is that the process is hard! And there is a prospect that they will travel down this difficult path, only to discover that the “answer” still eludes them. Yet, the key lesson to learn is that the process itself has value. Through it all, families make themselves stronger and expand their potential for wealth, even if it appears that they have not landed on the one true answer. And by following a process, families can avoid isolated solutions that only deal with one set of issues, ignoring the overall family, owner, and enterprise systems and the family’s shared values. For example, an estate planning attorney may draft a perfectly valid set of documents, but if she does not coordinate with the liquidity needs of the business, the estate plan has the potential of failing its ultimate objective. Similarly, a consultant may help design the perfect governance system, but if the estate plan is ignored, it can be shattered by poor tax planning. So, following the path will help coordinate advisers and lead to a more holistic plan for long-term family wealth.

### **How Can a Family Get Started?**

A number of very useful organizations and private consulting firms have rushed to fill the needs of family businesses. For example, many universities and colleges around the United States have family business centers, which cater to providing useful information and education to family businesses (see, for example, the University of Wisconsin Family Business Center, <http://fbc.wisc.edu/>). In addition, large, international organizations such as the Family Firm Institute, Inc. ([www.ffi.org](http://www.ffi.org)) are advancing the body of knowledge for family businesses and their advisers. Most recently within the United States, a new family business advocacy group was formed, called Family Enterprise USA ([www.familyenterpriseusa.org](http://www.familyenterpriseusa.org)), to create a collective

identity and voice for family enterprises and to recognize and promote their unique needs and interests. These organizations, and others like them, are invaluable tools for family business.

As the field develops, it has become clear that family businesses are different from other enterprises. For example, there tends to be a stronger desire for the business to continue after the founder's death than with the passing of a founder in a non-family business; family values and family harmony become intertwined with the success or failure of the business. Also, the lines between family and ownership become blurred, making control of the business a family issue. These intersections of family, ownership, and enterprise also mean that the family business often goes beyond the operating business itself. Everything the family owns becomes part of a larger enterprise, encompassing real estate holdings, outside investments, charity, vacation homes, politics, art, and so on, as well as the family's intangible assets, such as its overall legacy, its history, and its responsible stewardship.

## **Conclusion**

In the developing field of family business consulting, families, the owners, the management, and the advisers serving all of them, should understand the unique nature of family businesses. Working through the systems and getting to the best balance of each participant's values, needs, and goals is a process. There is no silver bullet, no universal answer, other than to begin, continue, and restart the process of establishing, maintaining, and advancing the family's wealth, in all its forms.

The developing field of advisers whose vocation is dedicated to business-owning families is likely to grow in experience and expertise over the next few years, as there appears to be growing momentum and realization that this approach works. Also, the amount of research being conducted in this field is growing exponentially, so the base of knowledge and experience continues to grow. At the same time, more and more consultants are being trained in and specifically preparing to assist family businesses and the families who own them, and more and more advisers are realizing that a truly multi-disciplinary approach has great merit for long-term family wealth.

For family businesses, I encourage you to build a team of professionals who believe in this approach and can effectively help you along your journey. Find advisers who believe this is their calling. Also, look for and identify your *personne de confiance*; he or she will be invaluable to keep you on track and help you and your advisers define and stay true to your family's shared values.

For advisers and consultants who would like to explore this field, I would encourage you to find kindred spirits in your part of the world to gather and share ideas. Also, join the Family Firm Institute and tap into its incredible knowledge base. If you are truly drawn to helping families on this path, consider getting the FFI Certificate in Family Wealth Advising or Family Business Advising. It is an excellent primer on how the field works and a way to tap into the latest and greatest thinking in the field.

For anyone interested in this field, I've provided some excellent books for further reading in the next section. They offer different perspectives and different approaches to the issues, but they all can help you begin your journey. It is a good and worthwhile journey, and I encourage you to join the rest of us on this path.

### **Suggested Further Reading**

- Randel S. Carlock and John L. Ward, *Strategic Planning for the Family Business: Parallel Planning to Unify the Family and the Business* (Palgrave Macmillan, 2001).
- Jane Hilburt-Davis and W. Gibb Dyer, Jr., *Consulting to Family Businesses: A Practical Guide to Contracting, Assessment, and Implementation* (Pfeiffer, 2003).
- James E. Hughes, Jr., *Family: The Compact Among Generations* (Bloomberg Press, 2007) (note the extensive list of further suggested reading contained therein).
- James E. Hughes, Jr., *Family Wealth: Keeping It in the Family* (Bloomberg Press, 2004) (note the extensive list of further suggested reading contained therein).
- John L. Ward, *Perpetuating the Family Business: 50 Lessons Learned from Long-Lasting Successful Families in Business* (Palgrave Macmillan, 2004).

## Key Takeaways

- Family business systems can be represented by a three-circle model consisting of family, ownership, and enterprise systems. Outside and surrounding these three circles, advisers (attorneys, accountants, psychologists, executive coaches, etc.), consultants (working in and among the various systems), and trusted advisers (acting as the key sounding board) play a critical role.
- Finding and maintaining the right balance between these three systems is central to designing a successful transition from one generation to the next.
- As a transition to a new generation approaches in a family business, tension can arise because later generations have different liquidity needs and are less likely to settle for “patient” capital. To effectively control these transitions, the family, owners, and managers each must implement effective governance structures to help find the right balance.
- Family businesses must also protect their human and intellectual capital, not only their financial capital.
- A family must identify its shared values and agree to abide by them.
- Successful family businesses (a) establish family values and form a social compact to preserve them, (b) use a team of coordinated professionals to design transition plans, and (c) establish effective governance structures and family policies before they are actually needed.
- In practice, it takes at least three to five years to develop a comprehensive, honest, and seamless business transition plan. Throughout that time, communication about values, needs, and goals and the process itself is critical.

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***Dedication:*** *Many thanks to James Hughes, who sparked my interest in this rewarding field and helped me to see that it is the holistic exploration of an issue as a complex whole that brings the client an answer he can integrate into his journey and his family's long-term well-being. Thanks to my team members, Brian Larson and Gretchen Cleveland, for their able assistance with this chapter. Thanks also to Deb Houden, director of the UW Family Business Center, and Ann Kinkade, president of Family Enterprise USA, for their insightful comments on this chapter. And, as always, thanks to my dear wife, Sara, who helps me in more ways than she could ever imagine.*



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