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Succession Planning

Plan Now to Ensure a Successful Transition ... Later

When **Marvin Schwan**, founder of Schwan's Foods, died and left the bulk of his estate to church-related organizations, it caused a serious rift among family members. As a result of apparent misunderstandings and a lack of awareness about the estate plan, Marvin's children have sued the trustees, one of which is their uncle, alleging that they have not followed Marvin's wishes. The trustees indicate that they have done *exactly* what Marvin wanted and are bewildered that his children

are filling a lawsuit when they have received a sizable inheritance.

I'm sure Marvin Schwan never thought he was going to have a problem when he completed the initial stages of his ownership/transition plan. But, then again, he probably didn't think he would die so suddenly either — before he had the opportunity to inform family members of his plans.

Marvin Schwan established a successful multi-billion dollar business and was an extraordinarily successful owner/entrepreneur, yet at the moment of his death, everything he worked for seems to have fallen apart. *What went wrong?*

While Schwan's is not a construction company, the dynamics parallel many other family businesses. As a result, there are lessons to be learned that may prevent a parallel tragedy from occurring in your family-owned business.

It's important to understand what makes ownership and management transitions in family-owned businesses so challenging: the overlap between two separate and distinct organizations — the family and the business. Let's examine each one.

The Family vs. The Business

The *family* is held together by strong emotional ties. The values that drive the family are protection and loyalty. The family exists primarily to cushion its members from changes occurring in the world at-large, and within their family circle. As a result, families tend to be conservative and resist change.

The *business* is oriented toward the production of goods and services. The values that drive the business are competency and productivity; to be successful, the business must embrace change. Therefore,

(Plan — cont'd on page 3)

By Thomas Hubler, President
Hubler Family Business
Minneapolis, Minnesota



For the past 17 years, Tom has been a family business consultant. He has authored many articles on success strategies for family-owned businesses and has been widely quoted in publications such as the *New York Times*, *Wall Street Journal*, *Business Week*, *Corporate Report*, *Nations Business*, and *Inc.*

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these two complex systems are in nearly direct opposition.

In the illustration to the right, the first model represents a non-family business. In the second illustration, which illustrates a healthy family business, there is a small, well-balanced overlap between family and business concerns. The third figure highlights the most common problem in family-owned businesses: the boundaries between business and family are indistinguishable. As a result, the business is vulnerable to family issues and entanglements; and business differences can erode family relationships.

In a recent, yet unpublished, article submitted for publication in a national journal for family businesses, the number one reason for failure of family businesses was inadequate ownership planning. Let's

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briefly look at key strategies and four basic plans that can act as a “North Star” to guide you in navigating these difficult waters.

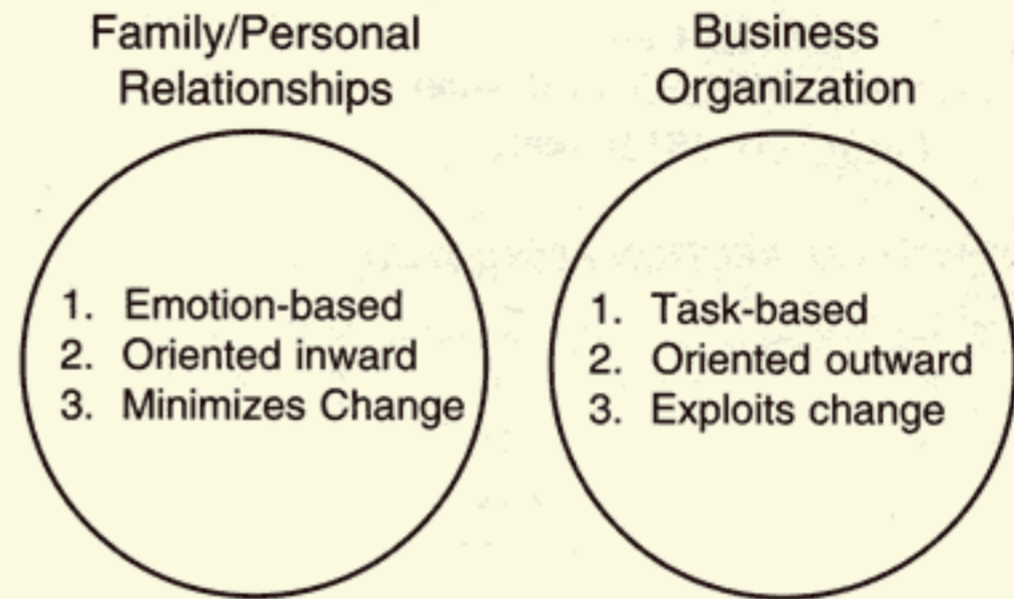
Key Strategy One

The first task is to *create an ownership and estate plan for the business* — one of the trickiest areas of planning because it involves the transfer of wealth, often complicated by tax planning, as well as the common circumstance of having children both in and out of the family business. There are five priorities in completing this plan:

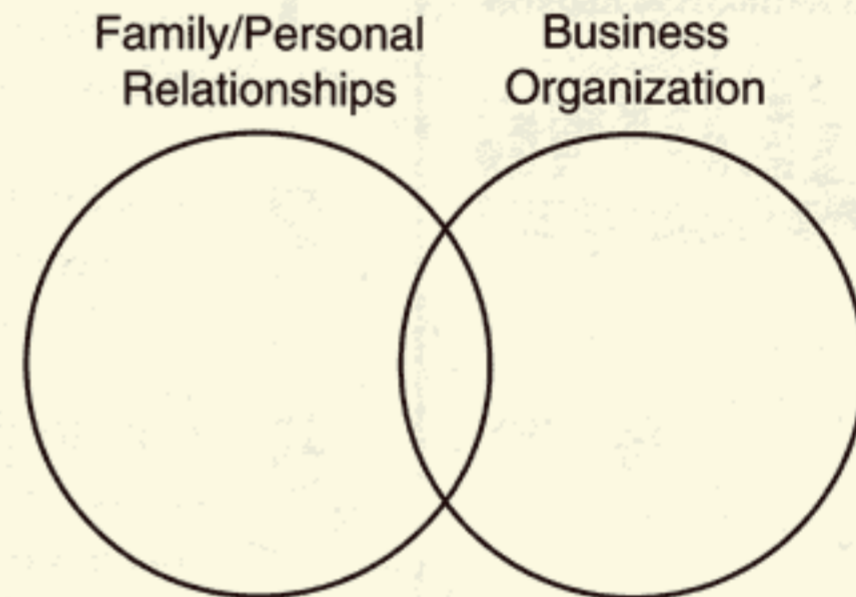
- ✓ Will there be another generation of the family in the business?
- ✓ How will we ensure economic security for the parents?
- ✓ How will we ensure the equitable treatment of the children?
- ✓ What steps can we take to minimize estate taxes?
- ✓ And, how will we communicate this plan to the family?

The most critical element is to determine whether or not there will be another generation entering the business. The family also needs to work with their professional advisors to ensure the economic security of the older generation. No plan is going to be successful

**Illustration I
System Differences**



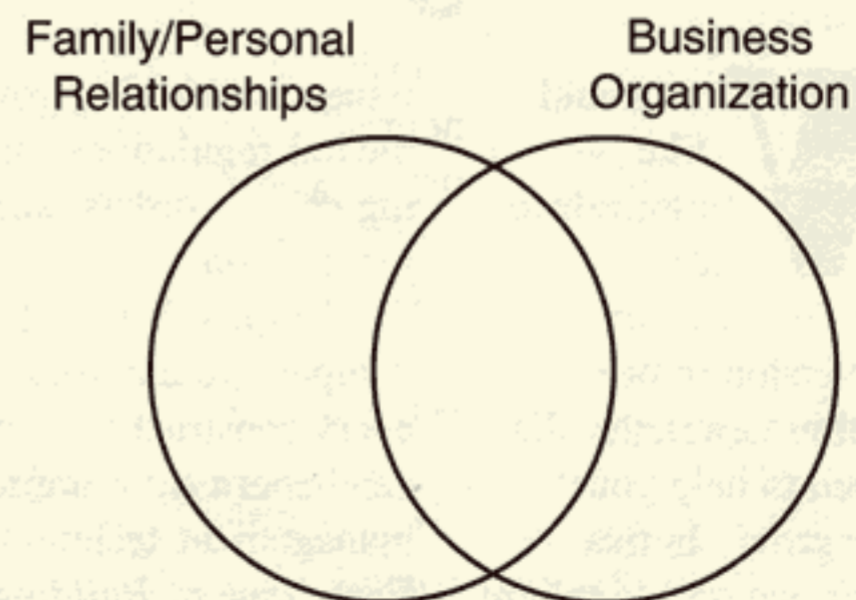
**Illustration II
Constructive Overlap**



Constructive Overlap Promotes:

- 1. Fulfilling family relationships
- 2. Successful business operations

**Illustration III
Excessive Overlap**



Excessive Overlap Creates:

- 1. Vulnerability of business to family and personal entanglements
- 2. Vulnerability of personal relationships to business issues
- 3. No refuge

unless this issue is addressed. The equitable treatment of the children is an additional consideration. This is very difficult for family businesses, because parents love their children equally, but the reality is that they are not always equal. The family needs to sit down and talk about what "equitable" means. This effort provides parents with the assurance that their children understand the plan and it helps minimize future family problems.

The family can collaborate with their accounting firm to implement a financial plan to achieve the family's goals well in advance of any transition, to implement plans that are the most tax-efficient plans possible. Entrepreneurs often end up paying excessive taxes because they avoided the planning process so long that many planning opportunities were lost.

Key Strategy Two

The second area of planning is to *create a management and leadership plan*. Selecting a leadership team for the next generation in the business is a difficult task, particularly when parent/child relationships are involved. It is important to work with outside advisors who can assist the owner/entrepreneur in making the right choices.

Given today's increased longevity and health, owner/

entrepreneurs often want to continue to make a contribution in the business, just as their adult children who are eager to make their own mark. It is critical that both the younger and the older generation both embark on career planning to create a "win-win" situation for all parties.

I often use the following analogy with clients who are struggling with this issue — that of "serving the B.O.S.S."

- ✓ The needs of the *business*
- ✓ The needs of the *other*
- ✓ The needs of the *self*
- ✓ The needs of the other *stakeholders* which includes; the family, the employees, the vendors, and all the people who have a stake in the company.

Key Strategy Three

The third area of planning is to *create a formal business plan* that addresses how the business will be managed during the transition from an entrepreneurial to a managerial organization that typically occurs between the first and second generation.

Key Strategy Four

Finally, I recommend that a family *create a common family vision and develop a family plan for the business*. This often becomes the glue that holds the whole plan together and provides the energy for all



the other areas of planning. A common family vision unites the family, especially the younger generation, for the future. It is a very powerful tool.

Regular meetings are critical. A recent study found that the number-one reason for success of family businesses was regular family meetings — a hybrid forum where family members address issues related to the family and the business. Family meetings allow family members to come together in a positive way to preserve their family relationships.

Planning is Crucial

While it is not always easy to predict the future, it is easy to say that if you have a plan, the probability of your success in ownership and management transitions will be much greater. Collaborating with your accountant and other advisors, and communicating regularly with your family will allow you to avoid the common pitfalls

"This (a common family vision and a family plan for the business) often becomes the glue that holds the whole plan together and provides the energy for all the other areas of planning."

that plague family-owned businesses.

I am confident that if Marvin Schwan were alive today, he would do everything in his power to honor the B.O.S.S., creating a win-win situation for himself, the business, his adult children, and the community he wished to serve in the process.

In the next issue of Building Together, we will continue our discussion of succession planning by highlighting some specific tax ramifications and alternatives for your consideration. If you have questions regarding succession planning, please contact your local Charles Bailly & Company P.L.L.P. representative. 